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No. 85- 18(1)

IN THE

Supreme Court of the United States

October Term, 1985

PITTSBURGH TERMINAL CORPORATION,

Petitioner,

vs.

THE BALTIMORE AND OHIO RAILROAD COMPANY, W. JAMES PRICE, ALONZO G. DECKER, JR., JAMES PARKER NOLAN, FREDERICK DEANE, JR., JAMES L. O'KEEFE, GREGORY S. DEVINE, FAY A. LeFEVRE, JOHN K. STEVENSON, HAYS T. WATKINS and HOWARD E. SIMPSON; THE CHESAPEAKE AND OHIO RAILROAD and THE CHESSIE SYSTEM, INC.,

Respondents,

and

MONROE GUTTMANN, LORETTA GUTTMANN, JANET REES and EVELYN BITTNER,

Petitioners,

vs.

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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Questions Presented

I. Whether the purposes of the federal securities law enforcement scheme are defeated by court holdings which deny both defrauded debenture-holders who subsequently sell and those who bought from them relief in a Sec. 10(b) action?

II. Whether judicial consideration of an offer of judgment in determining the damages to be awarded violates Federal Rule of Civil Procedure 68?

III. Whether judicial consideration of a Rule 68 offer of judgment to deny plaintiffs prejudgment interest violates the RULES ENABLING ACT?

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Opinions Below

Petitioner-Plaintiffs are Pittsburgh Terminal Corporation, Monroe Guttmann, Loretta Guttmann, Janet Rees and Evelyn Bittner [hereinafter jointly referred to as "PTC"]. Petitioners are holders or former holders of Baltimore and Ohio Railroad Company 4½% convertible debentures who held these securities on December 13, 1977.

This Petition arises out of a split decision of the Court of Appeals for the Third Circuit in the consolidated cases of *Pittsburgh Terminal Corporation v. The Baltimore and Ohio Railroad Company,* and *Monroe Guttmann, Loretta Guttmann, Janet Rees and Evelyn Bittner v. The Baltimore and Ohio Railroad Company,* Nos. 84-3331 and 3332, affirming the District Court's judgment for PTC at 586 F. Supp. 1297 (W.D.Pa. 1984) (App. 1a). The opinion of the Court of Appeals is noted at 760 F.2d 260 (3d Cir. 1985) and is attached hereto at App. 24a.

The earlier opinion of the Court of Appeals finding liability under Sec. 10(b)-5 in favor of PTC is reported at 680 F.2d 933 (3d Cir.), *cert. denied,* 459 U.S. 1056 (1982) (App. 34a).

A related *en banc* 3-3-2 opinion of the Court of Appeals addressing the issue of assignability arising from these same transactions is reported at *Lowry v. Baltimore & Ohio R. Co.,* 707 F.2d 721 (3d Cir.), *rehearing denied,* 711 F.2d 1207, *cert. denied,* 104 S.Ct. 238 (1983). The Panel's opinion here when read in conjunction with the *en banc* opinion in *Lowry* means that neither PTC as a defrauded seller, nor Lowry as representative of the purchasers of these securities, will receive a remedy. Under the holdings of the Third Circuit relief for securities law violations is available only to wronged security holders who are able to retain their securities throughout the entire course of the litigation.

Statement of Jurisdiction

Jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

Jurisdiction in the District Court was based on Section 27 of the Securities Exchange Act, 15 U.S.C. §77aa, 28 U.S.C. §1332. PTC's appeal was taken to the Court of Appeals pursuant to 28 U.S.C. §1291.

The judgment of the Court of Appeals was entered on February 28, 1985. PTC's petition for rehearing or rehearing *en banc* was denied on April 8, 1985. This petition for certiorari was filed within ninety days of that date.

Statutory Provisions Involved

Title 28 U.S.C. Fed.R.Civ.P. 68 provides in relevant part:

> At any time more than 10 days before the trial begins, a party defending against a claim may serve upon the adverse party an offer to allow judgment to be taken against him for the money or property or to the effect specified in his offer, with costs then accrued. If within 10 days after the service of the offer the adverse party serves written notice that the offer is accepted, either party may then file the offer and notice of acceptance together with proof of service thereof and thereupon the clerk shall enter judgment. An offer not accepted shall be deemed withdrawn and evidence thereof is not admissible except in a proceeding to determine costs. If the judgment finally obtained by the offeree is not more favorable than the offer, the offeree must pay the costs incurred after the making of the offer. The fact than an offer is made but not accepted does not preclude a subsequent offer. When the liability of one party to another has been determined by verdict or order or judgment, but the amount or extent of the liability remains to be determined by further proceedings, the party adjudged liable may make an offer of judgment, which shall have the same effect as an offer made before trial if it is served within a reasonable time not less than 10 days prior to the commencement of hearings to determine the amount or extent of liability.

Title 28 U.S.C. §2072 provides in relevant part:

> The Supreme Court shall have the power to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure of the district courts and courts of appeals of the United States in civil actions, including admiralty and maritime cases, and appeals therein, and the practice and procedure in proceedings for the review by the courts of appeals of decisions of the Tax Court of the United States and for the judicial review or enforcement of orders of administrative agencies, boards, commissions, and officers.
>
> Such rules shall not abridge, enlarge or modify any substantive right and shall preserve the right of trial by jury as at common law and as declared by the Seventh Amendment to the Constitution.

Statement of the Cases

On June 3, 1982 the Court of Appeals for the Third Circuit found that a scheme whereby Respondent-Defendant Baltimore and Ohio Railroad ["B&O"] transferred most of its non-rail assets to its subsidiary, the Mid-Allegheny Corporation ["MAC"] and that same day declared a dividend in kind of MAC's stock to B&O's common shareholders without timely notice to B&O's convertible debentureholders constituted a "manipulative or deceptive device or contrivance in violation of section 10(b)." *Pittsburgh Terminal Corp. v. Baltimore & O. R. Co.*, 680 F.2d 933, 943 (3d Cir. 1982), *cert. denied*, 459 U.S. 1056 (1982).[1] The Court of Appeals remanded the case for determination of an appropriate remedy.

After the liability determination in *Pittsburgh Terminal*, an *en banc* Court of Appeals in a related case brought by purchasers of the debentures who had purchased their securities from the defrauded sellers equally divided on the question of whether the cause of action for the Sec. 10(b) violation was automatically assigned upon sale of the debenture, or whether it remained with the original wronged debentureholders. *Lowry v. Baltimore & Ohio R. Co.*, 707 F.2d 721 (3d Cir.), *rehearing denied*, 711 F.2d 1207, *cert. denied*, 104 S.Ct. 238 (1983).

Dismissal of the *Lowry* federal claims was affirmed by the *en banc* court by a 3-3-2 vote (two judges having recused themselves), thereby preventing persons who

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[1] At the time of these transactions, B&O was 98% owned by Respondent-Defendant Chesapeake and Ohio Railroad ["C&O"] which in turn was 100% owned by Respondent The Chessie System, Inc. ["Chessie"]. For purposes of this Petition all of the Defendant-Respondents are jointly referred to as B&O unless otherwise noted.

purchased the debentures after December 13, 1977 from obtaining relief for the securities violation found by the Court of Appeals in *Pittsburgh Terminal.*

In remanding *Pittsburgh Terminal* to the District Court for determination of an appropriate remedy, the Court of Appeals had stated:

> "The District Court speculated that devising an appropriate remedy might be difficult. So it may be, but the Bondholders were the victims of a section 10(b) violation, and they are entitled to be heard about what the remedy should be. Since the District Court did not rule on the matter of relief, nothing is before us on that aspect of the case which we can intelligently review. A remand is required so that the trial court can fashion an appropriate remedy for the violation we have found." *PTC,* 680 F.2d at 943.

In the District Court PTC by Affidavit filed on October 20, 1983 advised the Court that three of the Petitioners had sold a number of their debentures.

On May 8, 1984 the District Court ordered for all of the Petitioners a remedy consisting solely of an opportunity to convert and receive unvalued possibly unregistered MAC stock.

The three Petitioners were not provided any remedy as to the debentures which they had sold during the pendency of the litigation even though the *Lowry* affirmance meant that subsequent purchasers could not assert any federal claims for the established securities law violations:

> "The remedy ordered here is limited to those persons who owned the subject debentures at the time of the violation, December 13, 1977, and who still own those debentures . . . Those persons who owned B&O debentures on December 13, 1977 and

> subsequently sold their debentures are not within the scope of either . . . this action or *Lowry*." 586 F.Supp. at 1305.

Finally, the District Court failed to award PTC any interest if it elected to convert on the difference between the dividends which it would have received on the B&O and MAC stock from December 13, 1977 onward and the interest which it received on the B&O debentures, although the amount of interest was ascertainable with mathematical precision.

On appeal the B&O's counsel at oral argument offered PTC some of the additional relief it was seeking by conceding that the District Court's Order should be amended to require registration and the availability of a registration statement before PTC made the election to convert:

> "[Mr. Wentley] I would also point out, if I may at this point, your Honors, with respect to Judge Weber's award, it is slightly amended to this extent as we disclosed in our brief, we are presently willing that the stock be registered and have taken steps, and are prepared to complete those steps so that they will receive the registered stock . . . And in registering the stock, if I may add this, it will also be present in the award that they receive, there will be a registration statement filed with the SEC. That registration statement will be provided to them prior to their having to make their decision. . . (91a).[2]

The Panel then affirmed the District Court's remedy but split on the contractual question of whether some relief should have been awarded to debentureholders who sold during the pendency of the litigation, Judge Higginbotham dissenting on that issue.

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[2] App. 89a. The Parties have now reached an agreement that the stock will be registered before the debentureholders are required to make their election to convert.

The Panel found that the denial of prejudgment interest was justified because PTC rejected an offer of judgment before trial under Fed.R.Civ.P. 68 (App. 92a) which it found provided the same relief (MAC stock upon conversion) as that ordered by the District Court in its May 8, 1984 Opinion. The offer of judgment was not filed in the District Court until August 3, 1984 (two months *after* the District Court ordered its remedy without interest) and was therefore considered for the very first time by the Court of Appeals without PTC having had an opportunity to present its factual contention that the relief offered was in fact less than that eventually obtained.[3]

PTC timely filed a petition for rehearing and/or rehearing *en banc* stating that the issue of whether a Fed.R.Civ.P. 68 Offer of Judgment could be used to deny substantive rights under Rule 68 or the Rules Enabling Act, 28 U.S.C. §2072, was before this Court in *Chesny v. Marek*, 720 F.2d 474 (7th Cir. 1983), *cert. granted*, _____ U.S. _____, 104 S.Ct. 2149 (1984) (No. 83-1437). PTC's petition was denied by Order dated April 8, 1985.

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[3] The Offer of Judgment was for unregistered stock and did not extend to debentureholders other than PTC (whom B&O on May 2, 1980 stipulated would be entitled to receive the same relief as PTC, App. 95a). Because in the appeal PTC obtained the right to receive a registration statement prior to the decision to convert and the right to receive registered MAC stock (App. 91a), PTC in fact obtained greater relief than that offered by B&O before the trial.

ARGUMENT IN SUPPORT OF ALLOWANCE OF THE WRIT

I. Holdings Which Prevent both Defrauded Debentureholders Who Sell and Those Who Purchased from Them from Obtaining any Relief Violate the Purposes of the Federal Securities Law Enforcement Scheme.

In *Lowry v. Baltimore & Ohio R. Co.*, 707 F.2d 721 (3d Cir. 1983), *rehearing denied*, 711 F.2d 1207, *cert. denied*, 104 S.Ct. 238 (1938), six members of the Court of Appeals for the Third Circuit sitting *en banc* agreed that there needed to be a resolution under federal law as to whether claims of securities law violations are automatically assigned upon sale of the subject securities or whether they remain with the wronged sellers. However the judges were equally divided and therefore unable to resolve the issue. All six judges who reached the assignment issue believed that either the defrauded holders who sold or the subsequent purchasers were entitled to relief.

Three judges of that court found that subsequent purchasers with knowledge sustained no loss and thus no injury from the violation, so that they should not be allowed to speculate on the injuries to predecessor holders:

> "In this light, absent any express assignment of a cause of action to the subsequent purchasers, it would be unjust and inconsistent with the remedial purposes of the securities laws to strip the right to recover from the convertible debentureholders who were actually injured, and grant it instead to subsequent purchasers who sustained no injury or loss from the Rule 10b-5 violation." 707 F.2d at 729 (Garth concurring)

Three judges, however, believed that a rule of automatic assignment was most consistent with the federal securities law enforcement scheme:

> "Requiring express assignment in the current securities market would drastically inhibit the effective assignability of 10(b) claims. The vast majority of securities transactions takes place in a faceless market where buyers and sellers never meet and may never have the opportunity to negotiate an express assignment. Under a rule of automatic assignment, the claim is transferred on purchase to the party most likely to learn of its existence, again maximizing the prophylactic value of the federal statute." 707 F.2d at 746. (Seitz dissenting)

Lowry's federal claims as a subsequent purchaser were dismissed on a 3-3 vote on the assignment question with 2 judges voting to dismiss the claims because in their view the finding of liability in *Pittsburgh Terminal* was erroneous.

On remand in *Pittsburgh Terminal* the assignment issue was again squarely raised. On October 20, 1983 Petitioner Monroe Guttmann filed an Affidavit in the District Court stating that he and Petitioners Loretta Guttmann and Janet Rees had all:

> "sold some of our debentures which we acquired prior to December 13, 1977 in reliance on the Defendants' affidavit that those who held debentures on December 13, 1977 would be entitled to receive the remedy awarded by the Court or received in settlement in the Civil Action Nos. 79-94 and 77-1455 (W.D.Pa)." (App. 101a)

The fact that three of the Petitioners had sold certain of their debentures was not disputed and all parties briefed and argued the issue of the relief to be awarded to persons including the three selling Petitioners.

The District Court declined to award any relief to Petitioners with respect to the debentures which they sold and the Panel affirmed stating:

> "It was . . . not error to exclude from the remedy persons who had sold their debentures." (footnote omitted) (App. 28a)

The Panel did not explain why Petitioners, as defrauded investors who sold their securities, should be deprived of a remedy.[4]

The result of the unresolved schism in the Court of Appeals resulting from *Lowry* and this case is a rule which only benefits securities law violators, *viz:* wronged debentureholders who sell are not entitled to relief and purchasers have no federal cause of action. This rule is inconsistent with every other federal court decision to consider the automatic versus express assignment issue as discussed below.

1. This Honorable Court Should Grant Certiorari to Resolve the Automatic Versus Express Assignment Issue.

This Court's Rule 17 provides for discretionary review on certiorari to resolve conflicts among the circuit courts of appeal and to resolve important federal questions. Application of either of these criteria support a grant of the writ in this case. The result of *Pittsburgh Terminal* and *Lowry* is that in the Third Circuit wronged debentureholders who sell their securities cannot obtain relief and subsequent purchasers who buy those securities cannot assert any federal claims for the

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[4] The Panel addressed the contractual claim issue presented by the B&O's stipulation but declined to address the statutory claim issue of entitlement under the Securities and Exchange Act presented by three of the Petitioners as defrauded investors who subsequently sold their securities. (App. 28a, n. 2).

established securities law violations. This rule is inconsistent with the law in other federal circuits. The only parties who benefit from the rule in the Third Circuit are violators of the securities laws.

The assignment issue presented here is an important matter of federal law which ought to be resolved by this court.

There are four federal cases known to PTC which address the assignment issue and which reach contradictory results. In *Phelan v. Middle States Oil Corp.*, 154 F.2d 978 (2d Cir. 1946) the Court of Appeals for the Second Circuit found that federal receivership claims were transferred by the sale of the underlying bonds. *Id.* at 999-1001. The *Phelan* rule was not applied here since as a result of *Lowry* subsequent purchasers of the debentures had their claims dismissed. In addition, *Phelan* does not represent the modern rule on assignability.

At least three district courts have found that the federal securities law enforcement scheme provide that injured investors retain their cause of action notwithstanding sale or transfer of the securities. *Independent Investor Protective League v. Saunders*, 64 F.R.D. 564, 572 (E.D.Pa. 1974); *Rose v. Arkansas Valley Environmental & Utility Authority*, 562 F.Supp. 1180, 1189 (W.D.Mo. 1983); and *In Re Nucorp Energy Securities Litigation*, _____ F.Supp. _____ (S.D.Cal. October 2, 1983) M.D.L. 514 (App. 102a), appeal pending at 83-6468 (9th Cir.).

A review of these cases indicates that they all conflict with the opinions of the Court of Appeals for the Third Circuit which provided no relief for either the wronged sellers or the purchasers of their securities.

In *Independent Investor Protective League v. Saunders*, plaintiffs who had purchased their securities from defrauded investors unsuccessfully advanced the theory that federal securities law claims were automatically transferred upon transfer of the debenture. The court, in a succinct opinion by Chief Judge Lord, unequivocally rejected the security purchasers' arguments, stating that federal securities laws create rights of action that, absent an express assignment, remain with the injured investor. The Court in *Saunders* summarized the plaintiffs' automatic assignment argument as follows:

> "Plaintiffs contend, however, that whatever causes of action may have accrued to a previous bondholder who owned the bonds at the time of defendants' alleged misconduct were automatically assigned to the current bondholder when he made his purchase. According to plaintiffs' theory, the simple act of buying a bond, without more, also purchases all rights of action that any prior holder might have had." *Id.* at 572.

The Court in *Saunders*, however, found the plaintiff-purchasers' argument to be meritless:

> "This contention is entirely without any support in precedent and, we think, totally without merit. Choses in action may be transferred from one party to another by express assignment. *International Ladies' Garment Workers Union v. Shields & Co.*, 209 F.Supp. 145 (S.D.N.Y. 1962); *In Re Penn Central Transportation Co.*, 337 F.Supp. 791 (E.D.Pa. 1972) (Fullam, J.). While a security is of course transferred by its sale, the causes of action belonging to a prior holder do not pass with the transfer of the security. The provisions of the securities acts relied upon here create rights of action on the part of the investors who have been harmed by the misconduct of others. Those rights

> belong to the *persons* who have suffered injury. They do not attach for all eternity to the security itself, to pass forever from the person who has been harmed to be asserted by others who have not. To adopt plaintiffs' extraordinary theory would be to deprive injured persons of their rights and give their causes of action to one who has suffered no injury himself but who simply has been shrewd or lucky enough to have put his hands on a security that once belonged to a person who was defrauded." (Emphasis added) *Id.* at 572.

The court in *Rose v. Ark. Val. Environ. & Utility Auth.*, 562 F.Supp. 1180 (W.D.Mo. 1983) agreed with the Court in *Saunders* stating:

> "[T]he fundamental premise underlying both *Birnbaum* and *Blue Chip* is that Rule 10-b-5 can apply, in any event, only to persons who have been defrauded by the securities violation in question . . . In the present case, however, it is rather obvious that plaintiffs . . . have not personally been defrauded in any way at all, even in the most general sense. Their respective predecessors may have been, but . . . any cause of action which might thereby have been created was personal to those predecessors; it did not inure in or automatically follow the security itself." *Id.* at 1189.

Under the reasoning of *Saunders, Rose* and *Nucorp* the three Petitioners who sold, as the defrauded security holders, clearly would have been entitled to a remedy. In the case *sub judice* PTC had proven that it was the victim of a Sec. 10(b) violation. But with respect to those debentures sold it was deprived of relief only because it had sold those debentures during the more than seven years of litigation between the violation and the award of relief.

The extraordinary rule adopted by the Third Circuit prevents purchasers of the securities who were not injured from prosecuting the claims and allows no relief to the wronged sellers. The result is that where defendants can prolong litigation, securities law violators are not accountable to many of the persons injured by their actions.

2. All Debentureholders Who Held on December 13, 1977 but Subsequently Sold Are Deprived of Relief.

In this case the District Court ordered as a remedy for damaged debentureholders who held on December 13, 1977 relief in the form of an opportunity to convert by September 1, 1984 and finally receive the MAC stock along with B&O common stock.[5] The problem with this "remedy" is that it denied any relief to those Petitioners and other debentureholders who sold during this prolonged litigation, thereby granting a windfall to B&O despite its adjudicated wrongdoing and its continuous representations during this litigation that persons who sold would be entitled to relief.

On May 2, 1980 B&O by its Counsel filed a stipulation in this action which provided:

> "[T]hat should the plaintiffs in the *Pittsburgh Terminal* and *Guttmann* actions prevail on the merits of their claims at trial or should a settlement of these claims be reached before trial, all holders of debentures as of December 13, 1977, whether or not they were subsequently converted, will be permitted to participate in the Court judgment or settlement on the same terms as the plaintiffs." (App. 96a)

[5] By Order filed June 12, 1984 this remedy was stayed.

Petitioners understood the Stipulation to include all defrauded investors who held their debentures on December 13, 1977 whether or not they subsequently sold their debentures.[6]

However, the District Court confined its remedy to "those persons who owned the subject debentures at the time of the violation, December 13, 1977, and who still own those debentures." 586 F.Supp. at 1305.

The District Court's limitation of the remedy to persons who did not sell their debentures throughout the more than seven year litigation is inconsistent with the cases cited above as well as representations made by B&O that defrauded investors who sold would be entitled to the remedy awarded.

On August 3, 1983 in *Lowry*, the Court of Appeals for the Third Circuit ordered the Parties including the B&O to brief *inter alia* their interpretations of the May, 1980 stipulation. The Court of Appeals in its order inquired:

> "5. If a different law of assignability applies to causes of action arising under federal and state law, what persons will be covered by the stipulation in *Pittsburgh Terminal Corp. v. Baltimore & Ohio R.R. Co.*, Nos. 81-1674/1675, that convertible debentureholders who are not parties will receive any benefits ultimately decided to be due to the individual plaintiffs in that case?"[7]

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[6] Petitioners were not the only persons who held debentures on December 13, 1977 but subsequently sold their debentures while B&O litigated for more than seven years. Between January 1, 1978 and the present it appears that over 50% of the outstanding debentures were traded on the New York Stock Exchange. See the Bank & Quotation Record, a publication of The Commercial and Financial Chronicle.

[7] A copy of the referred to stipulation is in the Appendix at 95a.

In response to this Court of Appeals' inquiry the B&O along with Petitioners agreed that defrauded sellers of debentures who held on December 13, 1977 were included within the stipulation. B&O in its Supplemental Brief to the Court in *Lowry* on that issue set forth its understanding of this Stipulation as follows:

> "The stipulation in *Pittsburgh Terminal Corp. v. Baltimore and Ohio Railroad Co., et al.*, at Nos. 81-1674/1675 relates to the debentureholders who owned their debentures on the day of the declaration of the MAC dividend *whether or not they subsequently sold* or converted their debentures. It was intended to insure that all of those debenture holders would be treated in exactly the same manner as the plaintiffs in those two consolidated actions should they prevail on the merits on their claims. This agreement . . . was intended to provide full protection for all of the debenture holders, whether or not they were formal parties to those suits." (Emphasis added) Defendants' Brief, p. 20. (App. 110a).

It is significant to note that a number of remedies were available to defrauded debenture sellers. See, *e.g., Chris Craft Industries v. Piper Aircraft*, 480 F.2d 341, 391 (2d Cir. 1973), *rev'd* on other grounds, 430 U.S. 1 (1977) (an award to defrauded security sellers of an opportunity to purchase and tender substitute securities). Alternatively the Panel could have ordered an accounting, as PTC had requested in the District Court. See *Glick v. Campagna*, 613 F.2d 31 (3d Cir. 1979) ("An accounting [could have provided] the parties an adequate opportunity to develop their position." *Id.* at 38). The mere fact that the District Court and the Panel found that PTC's first choice of a remedy (damages) was speculative did not negate their duty to award an alternative appropriate remedy. *City of Los Angeles v. Lyons*, 461 U.S. 95, 130-

31 (1983) and *Holt Civic Club v. Tuscaloosa*, 439 U.S. 60, 65-66 (1978). No remedy is not an appropriate remedy where, as here, a securities violation is alleged and proven.

In summary in the case *sub judice* PTC proved that it was the victim of a Sec. 10(b) violation but it was deprived of any relief with respect to those debentures sold simply because they had been sold.

The extraordinary holdings of the Court of Appeals in *Lowry* and *Pittsburgh Terminal* when read together proscribe purchasers of the securities who were not injured from prosecuting the claims and denies relief to defrauded debenture sellers including in this case three of the Petitioners. The result is that Defendants who can prolong litigation are not held accountable to many of the investors injured by its violations. The Panel did not "make good the wrong done." *Bell v. Hood*, 327 U.S. 678, 684 (1946).

The Court of Appeals' holdings present an important matter of federal law which encourages protracted litigation, deprives injured investors of relief, and destroys the prophylactic value of the federal security statute. It is respectfully submitted that these untoward results should be reviewed by this Honorable Court.

II. Judicial Consideration of an Offer of Judgment in Determining the Damages to be Awarded Violates Federal Rule of Civil Procedure 68.

Fed.R.Civ.P. 68 states that an offer of judgment which is not accepted "shall be deemed withdrawn and evidence thereof is *not admissible* except in a proceeding to determine *costs*." (Emphasis added) The Committee Note of 1946 to Amended Rule 68 states specifically that "The third sentence of Rule 68 has been altered to make clear that evidence of an unaccepted offer is admissible in a proceeding to determine the *costs of the action but is not otherwise admissible*." (Emphasis added)

In these cases B&O properly filed its offer of judgment with the District Court on August 3, 1984 *after* the District Court by order dated May 8, 1984 awarded PTC the MAC stock remedy. Since the offer was not filed until afterwards the District Court could not and did not consider the offer of judgment when it determined not to award pre-judgment interest to PTC on its rescissory damages award.

However, the Panel expressly considered the B&O's offer of judgment as grounds for denying PTC prejudgment interest:

> "The record here shows that in 1979 the appellees made an offer of judgment that would have given the appellants the same remedy that the district court awarded them in 1983. While the appellants had no obligation to accept this offer of judgment, the ensuing delay in their receipt of B&O and MAC dividends is attributable to their refusal, not to any fault on B&O's part." (App. 28a).

Thus, the offer of judgment was admitted and used in a proceeding (*i.e.*, the appeal) other one than to determine costs.

The opinion of the Panel which relies on the offer of judgment to deny pre-judgment interest as part of PTC's damages conflicts with the plain language of the rule itself. See also *Mason v. Belieu,* 543 F.2d 215 (D.C.Cir. 1976), *cert. denied,* 429 U.S. 852 (1976) where the Court of Appeals stated:

> "If the offer is not accepted, it can be used only to oppose the award of costs after the plaintiff has filed his bill; the court is not otherwise apprised of its existence. See 12 C. Wright & A. Miller, Federal Practice and Procedure §3002, at 57 (1973)." *Id.* at 222.

Since the use of Fed.R.Civ.P. 68 offers of judgment in the federal courts is increasing, and there is now a split of authority as to their use in deciding matters unrelated to the assessment of costs, PTC respectfully requests that this Honorable Court grant certiorari to resolve the conflict between the plain language of Rule 68 and the Panel's use of the Rule in this case.

III. Judicial Consideration of a Rule 68 Offer of Judgment to Deny Petitioners' Pre-Judgment Interest Violates the Rules Enabling Act.

The permissible use of Fed.R.Civ.P. 68 offers of judgment under the Rules Enabling Act is an issue presently pending before this Honorable Court. *Marek v. Chesny,* No. 83-1437.

The Rules Enabling Act, 28 U.S.C. §2072, provides that the Supreme Court has the power to prescribe rules of procedure for the district courts but that:

> "Such rules shall not abridge, enlarge or modify any substantive right. . ."

In *Hanna v. Plumer,* 380 U.S. 460 (1965) this Court acknowledged that although there is a presumption in favor of the validity of a Federal Rule, a court must invalidate the use of a Federal Rule which demonstrably interferes with a substantive right. *Id.* at 471-72.

In this case, the Panel used an offer of judgment made pursuant to Fed.R.Civ.P. 68 to deny PTC pre-judgment interest on the difference between the B&O and MAC stock dividends and the interest paid on the B&O debentures. (App. 27a-28a) The issue, then, is whether entitlement to prejudgment interest is a substantive right within the meaning of the Rules Enabling Act.[8]

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[8] This Court has recognized that pre-judgment interest is an element of damages to "be awarded as a component of full compensation" which if denied "Create[s] an incentive to prolong litigation." *General Motors Corp. v. Devex Corp.,* 461 U.S. 648, 655 n. 10 (1983). In *General Motors* this Court also described the federal common law rule that "a plaintiff's damages were often treated as liquidated if they were relatively certain and ascertainable by reference to established market values." 461 U.S. at 652, n. 5.

In this case the District Court awarded PTC (and similarly situated debentureholders) on their retained debentures the opportunity to obtain MAC stock together with B&O common stock on conversion of their B&O debentures. The District Court also awarded to those defrauded investors the amount representing the difference between the dividends paid by B&O and MAC since December 13, 1977 and the interest they received on the debentures. Since that amount (dividends on B&O and MAC minus interest on debentures) is certain and ascertainable with mathematical precision, pre-judgment interest should have been awarded as a matter of federal common law right absent exceptional circumstances. *Eazor Exp. Inc. v. International Bro. of Teamsters*, 520 F.2d 951, 973 (3d Cir. 1975), *cert. denied*, 424 U.S. 935 (1976) and cases cited therein. Also see *Banco Nacional DeCuba v. Chase Manhattan Bank*, 505 F.Supp. 412, 448 (S.D.N.Y. 1980), *affirmed on other grounds*, 103 S.Ct. 2591 (1983) and *Ambromovage v. United Mine Workers of America*, 726 F.2d 972, 981 n. 25 and n. 30 (3d Cir. 1984). Moreover, B&O had the use and benefit of the money during the pre-judgment period and was able to earn interest on it. See, *e.g.*, *First Nat. Bank of Chicago v. Material Serv. Corp.*, 597 F.2d 1110, 1121 (7th Cir. 1979).

The District Court did not find any facts or state any conclusions of law as required by Fed.R.Civ.P. 52 in support of its denial of pre-judgment interest so that any review of its exercise of discretion was impossible on the record presented to the Panel. The Panel should have remanded the case to the District Court and required it to state its reasons for the denial of pre-judgment interest. *Worthy v. United States Steel Corp.*, 616 F.2d 698, 701 (3d Cir. 1980). *Cf. Singleton v. Wulff*, 428 U.S. 106, 121 (1976). This also would have permitted PTC to

present evidence that it received more after trial than had been offered by B&O. See, *e.g.*, p. 9, n. 3 of this Petition.

Instead, the Panel considered evidence not before the District Court in the form of B&O's Fed.R.Civ.P. 68 pretrial offer of judgment filed after the District Court wrote its opinion denying pre-judgment interest, and concluded that it formed a proper basis for denying pre-judgment interest. (App. 27a-28a)

PTC believes that this is the first time that a district court has found that a Fed.R.Civ.P. 68 offer of judgment if rejected can be used as a basis for terminating a plaintiff's right to pre-judgment interest.

The issue of whether a Rule 68 offer of judgment can be used to cut off a plaintiff's rights to attorneys fees under 42 U.S.C. §1988 is currently before this Honorable Court, *Marek v. Chesny*, No. 83-1437. The *PTC* cases present a clearer conflict of Rule 68 with the Rules Enabling Act than *Marek* because there is no claim here that an entitlement to pre-judgment interest is a "cost" within the meaning of Rule 68.

Since the extent to which the substantive right to prejudgment interest can be cut off by a Rule 68 offer of judgment is an important federal question which ought to be resolved, PTC respectfully requests that this Honorable Court grant its petition for writ of certiorari or alternatively, grant and remand for proceedings consistent with *Marek v. Chesny*, No. 83-1437.

Conclusion

For the reasons stated above, Petitioners Pittsburgh Terminal Corporation, Monroe Guttmann, Loretta Guttmann, Janet Rees and Evelyn Bittner respectfully request this Honorable Court to grant their Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit.

Respectfully submitted,

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Certificate of Service

The undersigned, who is a member of the Bar of this Court, hereby certifies that three copies of the within Petition for Writ of Certiorari were served upon the following individuals at the addresses shown below by first class United States Mail, postage prepaid on July 3, 1985:

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APPENDIX A

Opinion of the United States District Court for the Western District of Pennsylvania (1984)

[1297] PITTSBURGH TERMINAL CORP. v. BALTIMORE & OHIO R. CO.
Cite as 586 F.Supp. 1297 (1984)

PITTSBURGH TERMINAL CORPORATION,

v.

The BALTIMORE AND OHIO RAILROAD COMPANY, W. James Price, Alonzo G. Decker, Jr., James Parker Nolan, Frederick Deane, Jr., James L. O'Keefe, Gregory S. Devine, Fay A. LeFevre, Nicholas T. Camicia, Dr. Milton S. Eisenhower, Steven Muller, John K. Stevenson, Hays T. Watkins, Howard E. Simpson and Cyrus S. Eaton, all Directors or former Directors of the Baltimore and Ohio Railroad, The Chesapeake and Ohio Railroad and/or the Chessie System, The Chesapeake and Ohio Railway Company and Chessie System, Inc.

Appendix A—Opinion of the United States District Court for the Western District of Pennsylvania (1984).

Monroe GUTTMANN, Loretta Guttmann, Janet Rees and Evelyn Bittner,

v.

The BALTIMORE AND OHIO RAILROAD COMPANY, W. James Price, Alonzo G. Decker, Jr., James Parker Nolan, Frederick Deane, Jr., James L. O'Keefe, Gregory S. Devine, Fay A. LeFevre, Nicholas T. Camicia, Dr. Milton S. Eisenhower, Steven Muller, John K. Stevenson, Hays T. Watkins, Howard E. Simpson and Cyrus S. Eaton, all Directors or former Directors of the Baltimore and Ohio Railroad, The Chesapeake and Ohio Railroad and/or the Chessie System, The Chesapeake and Ohio Railway Company and Chessie System, Inc.

Civ. A. Nos. 77-1455, 79-94.

United States District Court, W.D. Pennsylvania.

May 8, 1984.

Holders of convertible debentures in railroad company brought action against company and others for alleged violation of Securities Exchange Act. The United States District Court, Knox, J., 446 F.Supp. 656 granted preliminary injunction, and railroad appealed. The Court of Appeals, 578 F.2d 1375 reversed. Holders then amended complaint to add claim for damages. The United States District Court for the Western District of Pennsylvania, 509 F.Supp. 1002 rendered judgment for defendant, and appeal was taken. The Court of Appeals, 680 F.2d 933, reversed and remanded for selection of

appropriate remedy. The District Court, Weber, J., held that: (1) further discovery in order to assist debenture holders in selecting and formulating remedy was not warranted; (2) book values on assets transferred by railroad company to wholly owned subsidiary were insufficient to support damage award; and (3) appropriate remedy was rescission which would allow debenture holders opportunity to convert to common stock in railroad corporation.

Order accordingly.

1. **Federal Civil Procedure—1267**

Trial court has wide discretion in discovery matters.

2. **Federal Courts—951**

Although question of whether to reopen proceedings on remand from Court of Appeals is committed to sound discretion of district court, remand is typically not intended to permit party to fill gaps in original record.

3. **Federal Civil Procedure—1269**

Convertible debenture holders were not entitled to additional discovery for purposes of formulating remedy for defendants' violation of securities laws, where holders had already conducted three years of extensive discovery, almost exclusively directed to question of damages, issue of damages had already been fully tried, and holders already stood in better position than if defendants had provided notice and opportunity to convert debentures to common stock in 1977 when they were required to do so.

Appendix A—Opinion of the United States District Court for the Western District of Pennsylvania (1984).

[1298] **4. Securities Regulation—154**

Where subject properties were carried for decades with book values of uncertain age and origin, so that book values were virtually useless and could not provide minimum value of unappraised properties, book values were insufficient to support damage award in action stemming from defendants' violation of securities law.

5. Securities Regulation—156

Rescission is appropriate remedy for securities violation.

6. Securities Regulation—149

Remedies for securities violation may be tailored to fit circumstances of individual case and assure equitable result.

7. Securities Regulation—156

Purpose of rescission in action stemming from securities law violation is to place injured party in same position he would have held in absence of violation; however, care must be taken that plaintiff is not placed in better position than he would have enjoyed, a situation which amounts to punishment of defendant.

8. Securities Regulation—156

Where due to railroad's deceptive practice, convertible debenture holders were deprived of opportunity to convert their debentures into common stock and participate in dividend when railroad's nonrailroad assets

were transferred to wholly owned subsidiary, and inadequacy of book values for property made award of damages speculative, rescission granting debenture holders opportunity to convert stock was appropriate remedy.

Michael P. Malakoff, Berger, Kapetan & Malakoff, Pittsburgh, Pa., for plaintiffs.

Anthony J. Basinski, Richard Wentley, John J. Repcheck, Houston, Harbaugh, Sharlock, Repcheck & Lippard, Pittsburgh, Pa., for defendants.

OPINION

WEBER, District Judge.

This complex and long-running securities litigation is now before us on remand from the Court of Appeals for the selection of an appropriate remedy for the defendants' violation of the securities law. Plaintiffs have moved for leave to take additional discovery for the purpose of formulating a remedy. In the alternative, plaintiffs seek a favorable damage award based on the existing record. Defendants have responded opposing any further discovery, and advancing rescission as appropriate relief. The parties have fully briefed these matters, we have reviewed the voluminous record, and the issue of remedy is now in proper posture for disposition.

Appendix A—Opinion of the United States District Court for the Western District of Pennsylvania (1984).

I. FACTS

A condensed recitation of the facts is necessary here. A more detailed understanding of the factual and procedural history of this litigation may be gleaned from previous opinions.[1]

Plaintiffs are holders of B & O Class A convertible debentures, acquired prior to December 1977, and maturing in 2010. The debentures pay 4.5% interest and are convertible to B & O common stock at any date prior to maturity. These B & O debentures are listed and traded on the New York Stock Exchange.

The central corporate figure in this complicated organizational table is the B & O Railroad. In December, 1977, the C & O, a [1299] Virginia corporation, owned 99.63% of B & O's common stock. The C & O in turn was wholly owned by the Chessie System, Inc., a holding company.

B & O common stock was once listed and traded on the New York Stock Exchange. By 1964 C & O had acquired 99% of B & O common, trading ceased and the stock was delisted. For 17 years no dividend was declared on B & O common stock, the last being in 1960.

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[1] 446 F.Supp. 656 (W.D.Pa.1978) (Knox, D.J.) (preliminary injunction granted); 578 F.2d 1375 (3d Cir.1978) (order dissolving preliminary injunction); 509 F.Supp. 1002 (W.D.Pa.1981) (Knox, D.J.) (opinion following non-jury trial, judgment for defendants); 680 F.2d 933 (3d Cir.1982) (reversing as to liability and remanding for remedy); cert. denied, 459 U.S. 1056, 103 S.Ct. 475-6, 74 L.Ed.2d 621 (1982); see also, related case, *Lowry v. The Baltimore & Ohio Railroad Co.*, 707 F.2d 721 (3d Cir.1983) (en banc, per curiam) (affirming in part, reversing in part and remanding); 711 F.2d 1207 (3d Cir.1983) (en banc) (petition for modification of judgment denied, Gibbons, J., dissenting); cert. denied, _____ U.S. _____, 104 S.Ct. 238, 78 L.Ed.2d 229 (1983).

Appendix A—Opinion of the United States District Court for the Western District of Pennsylvania (1984).

In 1977, the B & O was the owner of a wide variety of properties, including both rail and non-rail assets. Because ICC regulations hampered development of the non-rail assets, a corporate reorganization plan was devised. Reduced to its simplest form, the plan essentially provided for the segregation of B & O's rail and non-rail assets, transfer of the non-rail assets to a wholly owned subsidiary titled Mid Allegheny Corporation (MAC), and distribution of the MAC common stock to B & O shareholders on a share for share basis. The scope of this reorganization was significant, involving the transfer of large amounts of potentially valuable real estate.

The properties selected for transfer to MAC were primarily non-rail assets with development potential which could not be effectively realized while the property remained under the Railroad's aegis with the attendant ICC restrictions. Most of these properties carried hopelessly outdated book values, and recent appraisals were rarely available.

In order to conserve time and money, the B & O sought to avoid registration of the MAC stock with the SEC. Registration would have required lengthy and expensive appraisals of the properties transferred to MAC, perhaps consuming up to 10 years.

To avoid registration, the B & O sought a no-action letter from the SEC. Because there were so few remaining B & O shareholders, a no-action letter was likely. However, the defendants recognized that an increase in the number of minority shareholders might force registration. To avoid this possibility, B & O

called its Convertible Income Bonds for redemption to prevent their conversion to B & O common stock. A different tactic was employed to prevent conversion of the debentures.

On December 13, 1977, the reorganization plan was put into effect by the B & O Board of Directors. The selected non-rail assets were transferred to MAC. The dividend in MAC stock was then declared to all B & O shareholders as of that same date. No prior notice was given of the dividend.

The effect of this action was to prevent the debenture holders from participating in the MAC dividend by depriving them of an opportunity to convert to B & O common stock in anticipation of the dividend. With the debenture holders effectively frozen out, registration was avoided.

Shortly after the Board action of December 13, 1977, Pittsburgh Terminal filed suit seeking an injunction against payment of the dividend in MAC stock. A preliminary injunction was granted by the District Court but was dissolved on appeal when the defendants agreed to hold sufficient shares of B & O and MAC stock to satisfy the claims of the plaintiffs and those similarly situated should they be successful in this litigation. See 446 F.Supp. 656 (W.D.Pa.1978) (Knox, D.J.); 578 F.2d 1375 (3d Cir.1978).

After a non-jury trial, Judge Knox rejected each of plaintiffs' claims and entered judgment for the defendants. 509 F.Supp. 1002 (W.D.Pa.1981). On appeal the Third Circuit reversed. 680 F.2d 933 (3d Cir. 1982).

The Court's majority decision rested on a holding that SEC Rule 10b-17, 17 C.F.R. §240.10b-17, imposed on the defendants a duty to provide prior notice of the MAC dividend to debenture holders. Failure to satisfy this obligation constituted a violation of Section 10(b) of the Securities Exchange Act of 1934. 15 U.S.C. §78j(b).

The Court of Appeals remanded for the determination of an appropriate remedy. This is no simple task, as recognized by both the original trial judge and the appellate panel. See, 509 F.Supp. at 1010; 680 [1300] F.2d at 943. We now resolutely address the question.

II. PLAINTIFFS' MOTION TO REOPEN DISCOVERY

Plaintiffs seek permission to engage in another round of discovery to assist them in selecting and formulating a remedy. Specifically, plaintiffs seek to inquire into MAC's transactions since the close of discovery, appraisals of MAC assets after 1979, and MAC's dealings with affiliates and subsidiaries.

Plaintiffs contend that such discovery is necessary to enable them to a ascertain MAC's current value, to compute an accurate damages figure, to make an informed decision on conversion as a remedy, and to identify any improper transactions between related companies which have worked to MAC's disadvantage.

[1, 2] A trial court has wide discretion in discovery matters. E.g. *Montecatini Edison S.p.A. v. E.I. DuPont de Nemours Co.*, 434 F.2d 70 (3d Cir.1970); *Swanner v. United States*, 406 F.2d 716 (5th Cir.1969). This court is expressly empowered to set necessary limitations on

discovery by Fed.R.Civ.P. 26(g). Specifically, the question of whether to reopen proceedings on remand is committed to the sound discretion of the District Court. *Rochez Brothers, Inc. v. Rhoades,* 527 F.2d 891, 894 (3d Cir.1975). However, remand is typically not intended to permit a party to fill in the gaps in the original record. *Id.,* at 894; *Moses Lake Homes, Inc. v. Grant County,* 276 F.2d 836, 853 (9th Cir.1960).

[3] A number of factors militate against the re-opening of discovery. First of all, plaintiffs have already conducted 3 years of extensive discovery, almost exclusively directed to the question of damages. Plaintiffs have viewed stacks of documents and compiled voluminous deposition transcripts. Significant discovery on this issue has already been had.

Secondly, the issue of damages has already been fully tried. Plaintiffs sought bifurcation between liability and damages, but this motion was denied. Judge Knox presided over the non-jury trial in which damage evidence was presented. Plaintiffs have had full opportunity to make presentation of evidence on remedy.

Plaintiffs contend that the additional discovery would permit a more accurate computation of the value of properties transferred from B & O to MAC in 1977. Because of the difficulties presented by outdated book values and the absence of recent appraisals, such a result would be desirable. However, while some additional information may have been compiled by MAC since the close of discovery, it appears that MAC still has vast amounts of property on which neither plaintiffs' nor

defendants can place a fair value. Because additional discovery would not resolve this difficulty of valuation, it would appear unwise.[2]

Plaintiffs insist that further discovery is necessary to permit them to make an informed decision on whether to pursue the MAC stock as a remedy, as opposed to damages. Certainly, such information might be helpful, but there does not appear to be sufficient need for it to justify the delay and expense attendant to re-opening discovery here. In 1977, MAC was a wild card, an unknown quantity. Today, plaintiffs have had the benefit of extensive discovery on MAC's assets, access to information released to the public by MAC and the B & O, and the opportunity to observe MAC's operations over the past 6 years. The acquisition of information from these sources reduces the need for further formal discovery on the matter.

Furthermore, plaintiffs stand today in better position as to information than if defendants had provided notice and opportunity to convert in 1977. Then plaintiffs would have had a short period of time and limited information on MAC with which to [1301] decide whether to convert. Today they have infinitely more information on MAC, although the picture remains incomplete. The purpose of a rescissory remedy, such as awarding a belated opportunity to convert and share in the MAC dividend, is to place the injured party in the same position he would have enjoyed but for the defendant's

[2] Here lies the distinction between this case and *Rochez Brothers, Inc. v. Rhoades*, 527 F.2d 891 (3rd Cir.1975) which allowed admission of further evidence on damages. Here it appears the effort would be futile.

actions. With the wealth of information on MAC now available to the plaintiffs, they stand in a better position than they would have had in 1977. Further discovery is therefore not justified.

For the reasons stated above, plaintiffs' motion to re-open discovery will be denied. The parties previously compiled a complete record on damages and no sufficient reason to supplement that record has been advanced.

III. DAMAGES

The original complaint in this action at 77-1204 sought only injunctive relief. With this in mind the Court of Appeals dissolved a preliminary injunction against payment of the MAC dividend when defendants agreed to hold sufficient shares of B & O and MAC to cover all B & O debenture holders. Plaintiffs later amended the complaint to add a claim for damages.

At the non-jury trial before Judge Knox, the parties presented evidence on damages. The evidence was limited, consisted of widely conflicting figures, and presented no readily acceptable formula for damages. Although Judge Knox outlined some of the problems with fashioning a remedy in this case, he made no findings on damages because he ruled for the defendants on liability. The Court of Appeals reversed and has now remanded the matter "so that the trial court can fashion an appropriate remedy for the violation we have found." 680 F.2d at 943.

Plaintiffs have urged on remand a computation of money damages based on a combination of appraised values where available, and B & O's existing book

values. Employing this method, the properties transferred from B & O to MAC have a minimum value of approximately $236,000,000. All Class A debentures, if converted, would net 5.2% of all outstanding B & O common stock. The claims of all debenture holders would then have a minimum total of some $12,000,000 or $930 per debenture.

There are, however, serious deficiencies in the building blocks of this computation which makes it inappropriate as a measure of damages. Principal among them is the inadequacy of book values.

[4] The subject properties were carried for decades with book values of uncertain age and origin. By 1977, the book values on these assets were hopelessly outdated. New uses, new circumstances, would affect the actual value of these properties. Some undeniably had a higher value than book. Others, according to testimony, had lower values. Because the book values are virtually useless and cannot provide a minimum value on unappraised properties, they are insufficient to support a damage award.

Plaintiffs' response is that book values are employed because the defendants have failed to make appraisals of the subject properties. While it is true that defendants have not conducted appraisals in many instances, defendants have no apparent legal obligation to do so. Though armed with a listing of MAC's properties, *plaintiffs* have made no effort to make appraisals in support of their claim for damages. Furthermore, by the nature of the properties involved, appraisals are speculative in that they are based on projections of distant future development.

Plaintiffs' computation of damages also fails to take into account the difference in value between a property owned by B & O and subject to ICC restrictions, and the same property owned by MAC and free to be developed. As long as B & O retained the non-rail assets, their value was severely limited. They could not be effectively developed because of ICC restrictions on use, issuance of securities, joint ventures and financing. Although plaintiffs contend that they have been deprived of a representative interest in valuable assets [1302] stripped from B & O, those assets could not realize their value until the B & O relinquished them. This paradox is not accounted for in plaintiffs' damages computation, and indeed does not appear to be susceptible to resolution in damages.

We find one other significant flaw in plaintiffs' damages theory. The computation is based on the premise that plaintiffs' conversion right has been damaged to the extent that B & O's non-rail assets were removed and transferred to MAC. Therefore, plaintiffs' theory goes, the measure of damages is the proportional interest in MAC's assets represented by plaintiffs' conversion rights. In other words, debenture holders could have converted for 5.2% of B & O common stock, and received 5.2% of MAC stock, and therefore should be awarded 5.2% of MAC's assets.

The difficulty is that we cannot know whether plaintiffs would have taken MAC. Plaintiffs would have had to convert their debentures, relinquish their value and future interest, to obtain stock which in one case was delisted and in the other may have been

unregistered. The damages theory is based on a valuation of a company which plaintiffs may well have decided against.

A more appropriate damages formula may have been to determine what portion of the fair market value of the debentures was attributable to the conversion option, and the extent to which that value was diminished by the removal of the non-rail assets. This would permit plaintiff to retain their debentures *and* obtain some measure of damages. It would appear that the value of the conversion right may have been negligible because B & O was no longer publicly traded and had not declared a dividend in 17 years. In any event, there is no evidence in the record to support any damage figure on such a theory.

We conclude therefore that there is no basis in the existing record for a damage award, either under plaintiffs' computation or any other theory. The inadequacy of both the book and fair market values in this case prevents any computation of damages which is other then speculation.

As Judge Knox noted:

> We have no information as to the value of these assets which could form the basis of any decree. There is nothing to base an award on and without these figures we have no nethod of determining what damages, if any, have been sustained by the Plaintiffs.

Furthermore, because of the flaws described above, plaintiffs' damages theory is not justified under the unique circumstances of this case and does not fit the

violation found. Our review of the record compels the same conclusion Judge Knox reached: plaintiffs have failed to prove damages.

IV. MAC STOCK AS A REMEDY

Early in this litigation, as discussed above, defendants agreed to hold sufficient shares of B & O and MAC common stock to satisfy the claims of all debenture holders. Defendants now urge as an appropriate remedy the distribution of those shares to such debenture holders as choose to convert. Defendants argue that this rescissory remedy would place the plaintiffs in the same position they would have enjoyed in December 1977 absent the violations. With certain modifications, we believe this offers the most equitable and the only workable form of relief.

[5, 6] There is no question that this court possesses equitable power to fashion an appropriate remedy. *Aaron v. Securities and Exchange Commission*, 446 U.S. 680, 100 S.Ct. 1945, 64 L.Ed.2d 611 (1980); *Securities and Exchange Commission v. Manor Nursing Centers, Inc.*, 458 F.2d 1082 (2d Cir.1972). Clearly rescission is an appropriate remedy for a securities violation. *Glick v. Campagna*, 613 F.2d 31 (3d Cir.1979). Furthermore, remedies may be tailored to fit the circumstances of the individual case and assure an equitable result. E.g., *Speed v. Transamerica Corp.*, 235 F.2d 369 (3d Cir.1956); *Arrington v. Merrill Lynch Pierce Fenner & Smith, Inc.*, 651 F.2d 615 (9th Cir.1981).

[1303] [7] The purpose of rescission is to place the injured party in the same position he would have held in the absence of the violation. E.g., *Glick*, 613 F.2d at 37. Care must be taken that plaintiff is not placed in a better position than he would have enjoyed, a situation amounting to punishment of the defendant. *Id.; Rolf v. Blyth, Eastman, Dillon & Co., Inc.*, 570 F.2d 38 (2d Cir.1978).

The unique factual circumstances of this case require a different approach to a remedy. As we have seen, typical computations of damages are inappropriate. A rescissory measure of *damages* is impossible because there is no purchase price to return. However, we can endeavor to restore to the plaintiffs the opportunity once denied them.

[8] Because of the defendant's deceptive practice, plaintiffs were deprived of the opportunity to convert their debentures into B & O stock and participate in the MAC dividend. The debenture holders' interest was damaged to the extent that their conversion right no longer included the opportunity to obtain a representative share of the non-rail assets.

The corporate reorganization of B & O was not itself a deceptive practice. There is no violation in B & O's decision to transfer its non-rail assets to MAC. Liability here is premised solely on the failure to provide prior notice of the dividend as required by SEC Rule 10b-17, an omission intended to prevent conversion of the debentures prior to the MAC dividend. 680 F.2d at 941, 945. Presumably then, if the debenture holders had been accorded prior notice of the reorganization and the MAC

dividend, and the opportunity to convert and participate in the dividend, there would have been no violation. The question now is whether we can restore that lost opportunity.

A somewhat analogous situation was present in *Speed v. Transamerica Corp.*, 235 F.2d 369 (3d Cir.1956). There plaintiffs, holders of Class A stock, were deprived of their opportunity to convert to Class B stock prior to liquidation. Because Class B enjoyed greater benefits in the liquidation, the court concluded that the proper remedy for the wrongful deprivation of the conversion right was to treat plaintiffs as if they had converted and owned Class B stock at liquidation. In the present case we are not certain whether conversion provides greater benefit to the plaintiffs, so we may leave the decision on conversion to them. *Speed* does indicate that this is a proper method to redress the wrongful deprivation of a conversion right.

The appropriate number of shares of B & O and MAC stock are still available to satisfy all debentures upon conversion. The debenture holders can be afforded a period of time to make a decision on conversion. Upon converting, the erstwhile debenture holder would receive the appropriate number of B & O shares, and the same proportion of MAC shares as if he had converted prior to declaration of the dividend of December 13, 1977. This conversion and retroactive participation in the dividend would permit debenture holders to retain their representative interest in both the rail and non-rail assets of the B & O. To this extent, plaintiffs would be in the same position they would have occupied in December, 1977 were it not for the violation.

Appendix A—Opinion of the United States District Court for the Western District of Pennsylvania (1984).

Plaintiffs object to the remedy on various grounds. It is first argued that MAC is not what it used to be. Plaintiffs assert that Chessie no longer intends to use MAC as its developing arm for the former B & O non-rail assets. Plaintiffs also claim that MAC's assets have been depleted through sweetheart transactions with subsidiaries and affiliates.

The short answer to plaintiffs' assertions about MAC's altered character and assets is that we have no reliable evidentiary material to support them. Nor can we allow plaintiffs to conduct a fishing expedition through discovery to find support. Furthermore, clamor over dealings with subsidiaries and affiliates which may or may not be proper would embroil us in another large and separate lawsuit. While collateral here, these issues might best be ad- [1304] dressed in a derivative suit. This does not appear to be the proper forum.

We do know something about MAC's operation since December 1977. Testimony in the non-jury trial held in the summer of 1979 revealed that MAC had retained its value to that point because it retained either the same assets transferred to it from B & O or the proceeds from the sale of such assets with an accounting of each transaction. Judge Knox made a specific finding of fact to this effect. 509 F.Supp. 1008. We also know now that in recent years both MAC and B & O have paid cash dividends. The facts available to us contradict plaintiffs' allegations.

Plaintiffs also contend that rescission of the type described would be improper because they are unable to make an informed decision on conversion, particularly

without further discovery. Our views on this topic have been presented above in our discussion of the need for discovery and are applicable here as well. Plaintiffs have a wealth of knowledge today that they would not have had and would not have been entitled to in 1977. Much of this information is confidential. Plaintiffs have had the advantage of viewing MAC and B & O in operation for 6 years, certainly more valuable and more reliable information than any representations as to MAC's future made in 1977. Although we agree that plaintiffs do not enjoy all the information one might wish for, they do possess sufficient data to enable them to make a reasoned judgment on conversion.

Plaintiffs also object because MAC stock is not registered with the SEC and is therefore not transferable. Defendants originally sought to avoid registration so as to also avoid the expense and delay of appraisals and compilation of a registration statement. Defendants still seek to avoid registration and they urge this court to hold a hearing under Section 3(a)(10) of the Securities Act of 1933, 15 U.S.C. §77c(a)(10), to approve distribution of MAC shares to converting debenture holders without registration.

We note first that hearings under Section 3(a)(10) have been previously employed in settlement situations, that is, where someone voluntarily accepted unregistered securities. E.g., *Securities and Exchange Commission v. Blinder Robinson & Co. Inc.*, 511 F.Supp. 799 (D.Colo.1981); *Brucker v. Thyssen-Bornemisza Europa N.V.*, 424 F.Supp. 679 (S.D.N.Y.1976), *aff'd* 559 F.2d 1202 (2d Cir.1977). We hesitate to force unregistered securities on an unwilling plaintiff.

Secondly, the grant of an exemption from registration would deprive converting debenture holders of a benefit they would likely have received in 1977. During the plainning stages of reorganization, the B & O recognized that an increase in the number of B & O shareholders would probably prevent the acquisition of a no-action letter from the SEC and require registration. While defendants made efforts to prevent conversions to B & O common stock, including the action giving rise to liability here, the December 13, 1977 resolution authorized preparation of a registration statement for MAC if the no-action letter was to be denied. Should sufficient numbers of debenture holders now choose to convert to B & O stock in order to participate in the MAC dividend we could not impose unregistered securities on them today, when they would have received registered securities in 1977.

By the same token however, defendants need not register MAC until after the debenture holders have made their decision on conversion. Once the conversion period expires, defendants are free to again seek a no-action letter or file a registration statement, dependent on their judgment of the situation, just as would have occurred in 1977 following conversion. If defendants choose not to seek a no-action letter, or if one is denied, defendants must proceed with registration.

Should the plaintiffs convert they would be entitled to consequential damages. Plaintiffs would be due all dividends paid on B & O and MAC common stock since December 13, 1977. However, in order to [1305] return the parties to their appropriate 1977 positions, plaintiffs would be required to return interest received on the

debentures in the interim. If but for the violation plaintiffs would have converted in 1977, they would have enjoyed the fruits of the stock ownership but foregone the benefits of the debenture. To effect rescission, this must be duplicated to the extent possible.

V. SCOPE OF REMEDY

Defendants previously agreed to extend any remedy obtained in this suit to other similarly situated debenture holders. There was some discussion and apparent confusion on appeal as to the make-up of this "class". We endeavor to define it.

The remedy ordered here is limited to those persons who owned the subject debentures at the time of the violation, December 13, 1977, and who still own those debentures. Those persons who owned debentures on December 13, 1977 and subsequently converted to B & O common stock may also elect to participate in this remedy, obtaining MAC and its dividends, offset by interest accruing on the debentures after December 13, 1977. Those persons who acquired B & O debentures after December 13, 1977 are within the class of *Lowry* plaintiffs, and their claims will be resolved in that litigation. Those persons who owned B & O debentures on December 13, 1977 and subsequently sold their debentures are not within the scope of either this action or *Lowry*.

VI. CONCLUSION

As stated above, we see no need to reopen the record in this case and plaintiffs' motion for additional discovery will therefore be denied. Furthermore, we conclude that the existing record does not provide a sufficient basis for calculation of damages, and plaintiffs' theory of damages does not fit the violation.

We conclude that rescission is the appropriate remedy here. It is the only remedy adaptable to the unique circumstances of this case and the one which most closely redresses the precise violation found by the Court of Appeals.

It will therefore be ordered that plaintiffs have until September 1, 1984, to choose to convert their debentures to B & O common stock. Plaintiffs shall then participate in the dividend in MAC stock on the same basis as shareholders of record on December 13, 1977.

Defendants request for a hearing under 15 U.S.C. §77c(a)(10) is denied. After plaintiffs have had opportunity to convert, defendants shall proceed to register the MAC stock unless they are able to obtain a no-action letter from the SEC.

By stipulation, defendants have agreed to extend the award in this suit to all debenture holders similarly situated. This remedy will be extended to all persons within the "class" described above. Defendants shall give notice of this opinion and order to the members of that class on or before July 1, 1984.

An appropriate order will issue.

APPENDIX B

Opinion of the United States Court of Appeals for the Third Circuit (1985)

[1] Not for Publication

UNITED STATES COURT OF APPEALS
For the Third Circuit

Nos. 84-3331 and 84-3332

PITTSBURGH TERMINAL CORPORATION,
Appellant in No. 84-3331,

vs.

THE BALTIMORE AND OHIO RAILROAD COMPANY, W. JAMES PRICE, ALONZO G. DECKER, JR., JAMES PARKER NOLAN, FREDERICK DEANE, JR., JAMES L. O'KEEFE, GREGORY S. DEVINE, FAY A. LE FEVRE, NICHOLAS T. CAMICIA, DR. MILTON S. EISENHOWER, STEVEN MULLER, JOHN K. STEVENSON, HAYS T. WATKINS, HOWARD E. SIMPSON and CYRUS S. EATON, all Directors or former directors of the Baltimore and Ohio Railroad, The Chesapeake and Ohio Railroad and/or the Chessie System, THE CHESAPEAKE AND OHIO RAILROAD and THE CHESSIE SYSTEM,

and

Appendix B—Opinion of the United States Court of Appeals for the Third Circuit (1985).

MONROE GUTTMANN, LORETTA GUTTMANN, JANET REES and EVELYN BITTNER,
Appellants in No. 84-3332,

vs.

THE BALTIMORE AND OHIO RAILROAD COMPANY, W. JAMES PRICE, ALONZO G. DECKER, JR., JAMES PARKER NOLAN, FREDERICK DEANE, JR., JAMES L. O'KEEFE, GREGORY S. DEVINE, FAY A. LEFEVRE, NICHOLAS T. CAMICIA, DR. MILTON S. EISENHOWER, STEVEN MULLER, JOHN K. STEVENSON, HAYS T. WATKINS, HOWARD E. SIMPSON and CYRUS S. EATON, all Directors or former directors of the Baltimore and Ohio Railroad, The Chesapeake and Ohio Railroad and/or The Chessie System, THE CHESAPEAKE AND OHIO RAILROAD and THE CHESSIE SYSTEM INC.

Appeal From the United States District Court For the Western District of Pennsylvania (Pittsburgh)
D.C. Nos. 77-1455 and 79-94
District Judge: Honorable Gerald J. Weber

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[2] Argued January 17, 1985

Before: HUNTER, HIGGINBOTHAM, *Circuit Judges,* and KELLY,* *District Judge*

Opinion filed FEB 28, 1985

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* Honorable James McGirr Kelly, United States District Judge for the Eastern District of Pennsylvania, sitting by designation.

Appendix B—Opinion of the United States Court of Appeals for the Third Circuit (1985).

[3] MEMORANDUM OPINION OF THE COURT

HUNTER, *Circuit Judge:*

1. On December 13, 1977, the Baltimore & Ohio Railway ("B & O") transferred its non-rail assets to a newly-organized subsidiary, the Mid-Allegheny Corporation ("MAC"), and declared a dividend-in-kind of MAC stock on B & O common stock. This was done without prior notice to holders of B & O convertible debentures, thereby depriving them of the opportunity to exercise their conversion options and participate in the MAC stock dividend. In *Pittsburgh Terminal Corp. v. Baltimore & O. Ry.*, 680 F.2d 933 (3d Cir.), *cert. denied*, 459 U.S. 1056 (1982), this court held that the failure of B & O and other corporate and individual defendants[1] to give the debenture-holders notice of the dividend-in-kind was a violation of section 10(b) of the Securities and Exchange Act, 15 U.S.C. §78j(b) (1982). The cause was then remanded to the United States District Court for the Western District of Pennsylvania for determination of "an appropriate remedy." 680 F.2d at 943.

2. On remand, the district court refused the attempt by the plaintiffs-appellants, individuals who had held B & O debentures on December 13, 1977, to have discovery reopened. It also rejected the appellants' demand for money damages as speculative, [4] and instead ordered that they be given the opportunity to convert their debentures to B & O common stock and participate in the dividend of

[1] The other defendants, now appellees along with B & O, were certain directors of B & O, the Chesapeake and Ohio Railway ("C & O"), which held more than 99% of B & O common stock, and the Chessie System, Inc., holding company for C & O and its subsidiaries.

MAC stock on the same basis as B & O shareholders of record on December 13, 1977. In this appeal, the appellants' primary argument is that the district court erred in these determinations. We think that we can add little to the reasons given by District Judge Gerald J. Weber for refusing to reopen discovery, rejecting appellants' theory of money damages, and determining that a rescissory remedy was the only appropriate one. We therefore adopt Judge Weber's excellent opinion in full.

3. We add, however, that we reject appellants' argument that this court's prior decision in this case holds that the appellants are entitled to damages despite the speculative nature of their calculations. That decision merely held that the difficulty of proving the amount of damages in this case was an insufficient reason to award judgment in favor of B & O. *See* 680 F.2d at 943. It did not, and could not, relieve the appellants of their burden of proving their entitlement to whatever relief they sought. "Although the law does not command mathematical preciseness from the evidence in finding damages, sufficient facts must be introduced so that a court can arrive at an intelligent estimate without speculation or conjecture." *Rochez Bros., Inc. v. Rhoades*, 527 F.2d 891, 895 (3d Cir. 1975), *cert. denied*, 425 U.S. 993 (1976).

4. The appellants also argue that the district court erred in not awarding pre-judgment interest on retroactive B & O and [5] MAC dividends that would be due any plaintiff who exercises the conversion option afforded by the district court judgment. The decision whether to award pre-judgment interest is committed to the equitable discretion of the trial court. *See, e.g., Blau v. Lehman*, 368 U.S. 403, 414 (1962); *Ambromovage v.*

UMWA, 726 F.2d 972, 982 n.2 (3d Cir. 1984); *Thomas v. Duralite Co., Inc.*, 524 F.2d 577, 589 (3d Cir. 1975). The record here shows that in 1979 the appellees made an offer of judgment that would have given the appellants the same remedy that the district court awarded them in 1983. While the appellants had no obligation to accept this offer of judgment, the ensuing delay in their receipt of B & O and MAC dividends is attributable to their refusal, not to any fault on B & O's part. It was, therefore, not inequitable for the district court to refuse to tax B & O for pre-judgment interest on these dividends.

5. The appellants also argue that the district court erred in refusing to extend the remedy to persons who had held B & O debentures on December 13, 1977 but had subsequently sold them. This argument is without merit. The actions here were not class actions, and the extension of the remedy to any persons other than the named plaintiffs was possible only by virtue of a stipulation by B & O that "all holders of debentures as of December 13, 1977, whether or not they were subsequently converted, will be permitted to participate in the Court judgment or settlement on the same terms as the plaintiffs." App. at 83. The district court correctly construed this stipulation as referring only to persons who still held their debentures, and [6] those who had converted them to B & O common stock. It was therefore not error to exclude from the remedy persons who had sold their debentures.[2]

[2] This case presents only the contractual question of whether the stipulation applies to persons who held B & O debentures on December 13, 1977 but subsequently sold them. We therefore have no occasion to decide whether those persons have a cause of action against B & O.

Appendix B—Opinion of the United States Court of Appeals for the Third Circuit (1985).

6. Finally, the appellants argue that the district court erred in failing to retain jurisdiction to supervise the formulation and distribution of notice to persons who are entitled to participate in the judgment by virtue of the B & O stipulation. As we noted above, these were not class actions, and thus the district court had no legal duty to supervise the notification of persons other than the plaintiffs. Nevertheless, the district court did order B & O to send notice and a copy of the judgment to all non-parties entitled to participate in the judgment by July 1, 1984. We think that this was adequate to protect the rights of these non-party beneficiaries of the judgment. Therefore, we cannot say that the district court abused its discretion in failing to retain jurisdiction.

7. For the foregoing reasons, the judgment of the district court will be affirmed.

TO THE CLERK

Please file the foregoing opinion.

JAMES HUNTER, III
James Hunter, III, *Circuit Judge*

[2] Pittsburgh Terminal Corp. v. The Baltimore and Ohio Railroad Co., et al. No. 84-3331; Monroe Guttmann et al. v. The Baltimore and Ohio Railroad Co., et al. No. 84-3332.

A. LEON HIGGINBOTHAM, JR., *Circuit Judge*, dissenting in part:

A. LEON HIGGINBOTHAM, JR.

Early in the course of this litigation appellants sought certification of a plaintiff class that would include, among others, all holders of the B & O convertible debentures as of December 13, 1977. App. at 76a. In response to this motion, appellees filed the affidavit of Robert F. Hochworth, an attorney for the Chessie System, who stipulated that

> on behalf of the B & O, C & O and Chessie, I have advised Chase [Chase Manhattan Bank, the Indenture Trustee] that should the plaintiffs in the *Pittsburgh Terminal* and *Guttmann* actions prevail on the merits of their claims at trial or should a settlement of these claims be reached before trial, all holders of debentures as of December 13, 1977, whether or not they were subsequently converted, will be permitted to participate in the Court judgment or settlement on the same terms as the plaintiffs. (App. at 83a.)

As a result of this stipulation, class action certification was denied. *Pittsburgh Terminal Corp. v. The Baltimore and Ohio Railroad Co.*, 680 F.2d 933, 939 (3d Cir.), *cert. denied*, 459 U.S. 1056 (1982). The majority agrees with the district court's conclusion that, under this

stipulation, "persons who owned B & O debentures on December 13, 1977 and subsequently sold their debentures are not within the scope of . . . this action . . . ." [3] App. at 568a. Because I believe that this interpretation of the admittedly ambiguous stipulation is contrary to both recognized canons of construction and the position previously asserted by appellees, I dissent from that portion of the majority opinion. In all other respects I join in the majority's affirmance of the thoughtful opinion and decree of the district court in this intricate case.

By its terms the stipulation applies to *all* holders of the debentures as of December 13, 1977. Any doubt as to whether this includes holders as of December 13, 1977 who subsequently sold must derive from the phrase "whether or not they were subsequently converted". The majority reads this inclusion language as creating an exception by implication, as if it said "except those holders as of December 13, 1977 who subsequently sold". Mindful of the maxims that all portions of a writing should be read naturally and, if possible, be given effect, *Hanley v. James McHugh Construction Co.*, 444 F.2d 1006, 1009 (7th Cir. 1971), and that an ambiguous writing should be construed strictly against the scrivener, *In Re F.H. McGraw & Co.*, 473 F.2d 465 (3d Cir.), *cert. denied*, 414 U.S. 1022 (1973), I am constrained from indulging in the poetic license the majority's interpretation would require.

Moreover, in pleadings before this court and the district court, appellees have previously taken the position that the stipulation covered holders as of December 13, 1977 who subsequently sold. In the closely

related case of *Lowry v. The Baltimore and Ohio Railroad Co.*, 707 F.2d (3d Cir.) (in [4] banc), *cert. denied*, _____ U.S. _____, 104 S. Ct. 238 (1983), where debenture holders who *purchased* after December 13, 1977 sought recovery, this court requested supplemental briefing on the question of "what persons will be covered by the stipulation" entered in this action. App. at 541a. In their supplemental brief appellees replied:

> The stipulation . . . relates to the debenture holders who owned their debentures on the day of the declaration of the MAC dividend [December 13, 1977] *whether or not they subsequently sold* or converted their debentures. It was intended to insure that all of those debenture holders would be treated in exactly the same manner as the plaintiffs . . . . (App. at 544a, emphasis added.)

In the instant case, after our remand for determination of an appropriate remedy, appellants moved for further discovery. App. at 329a-342a. In response, appellees argued that appellants were merely seeking information in order to determine whether to sell their debentures, and that this information was irrelevant because "*whether or not they sell* their Debentures they will still be entitled to any relief given by this Court in accordance with the agreement made by the B & O with the Trustee for the Debentures." App. at 344a (emphasis added). The motion for further discovery was denied. Having twice asserted this position when it suited their purposes, appellees ought not to be heard to assert the opposite now. As Judge Hastie once wrote for this court, a party

> who has obtained relief from an adversary by asserting and offering proof to support one position may not be heard later in the same court to contradict [5] himself in an effort to establish against the same adversary a second claim inconsistent with his earlier contention. Such use of inconsistent positions would most flagrantly exemplify that playing "fast and loose with the courts" which has been emphasized as an evil the courts should not tolerate. . . . And this is more than affront to judicial dignity. For intentional self-contradiction is being used as a means of obtaining unfair advantage in a forum provided for suitors seeking justice.

Scarano v. Central R. Co., 203 F.2d 510, 513 (3d Cir. 1953); *see also Allen v. Zurich Insurance Co.*, 667 F.2d 1162 (4th Cir. 1982).

For the foregoing reasons, I would vacate that portion of the district court's order limiting relief to holders as of December 13, 1977 "who still [have] those debentures or have since converted those debentures to B&O common stock," App. at 547a, and remand for determination of an appropriate mechanism for extending relief to holders as of December 13, 1977 who subsequently sold. As to these persons the district court could consider the tender of substitute debentures and/or damages as appropriate relief—the precise terms would require some further development of the record.

APPENDIX C

Opinion of the United States Court of Appeals for the Third Circuit (1982)

[933] PITTSBURGH TERMINAL CORP. v. BALTIMORE & O. R. CO.
Cite as 680 F.2d 933 (1982)

PITTSBURGH TERMINAL CORPORATION,
Appellant,

v.

The BALTIMORE AND OHIO RAILROAD COMPANY, W. James Price, Alonzo G. Decker, Jr., James Parker Nolan, Frederick Deane, Jr., James L. O'Keefe, Gregory S. Devine, Fay A. LeFevre, Nicholas T. Camicia, Dr. Milton S. Eisenhower, Steven Muller, John K. Stevenson, Hays T. Watkins, Howard E. Simpson and Cyrus S. Eaton, all Directors or former Directors of The Baltimore and Ohio Railroad, The Chesapeake and Ohio Railroad and/or the Chessie System, The Chesapeake and Ohio Railway Company and Chessie System, Inc.

Appendix C—Opinion of the United States Court of Appeals for the Third Circuit (1982).

Monroe GUTTMANN, Loretta Guttmann, Janet Rees and Evelyn Bittner,
Appellants,

v.

The BALTIMORE AND OHIO RAILROAD COMPANY, W. James Price, Alonzo G. Decker, Jr., James Parker Nolan, Frederick Deane, Jr., James L. O'Keefe, Gregory S. Devine, Fay A. LeFevre, Nicholas T. Camicia, Dr. Milton S. Eisenhower, Steven Muller, John K. Stevenson, Hays T. Watkins, Howard E. Simpson and Cyrus S. Eaton, all Directors or former Directors of The Baltimore and Ohio Railroad, The Chesapeake and Ohio Railroad and/or the Chessie System, the Chesapeake and Ohio Railway Company and Chessie System, Inc.

Nos. 81-1674, 81-1675.

United States Court of Appeals,
Third Circuit.

Argued Dec. 16, 1981.

Decided June 3, 1982.

Rehearing and Rehearing In Banc
Denied July 8 and July 9, 1982.

Appendix C—Opinion of the United States Court of Appeals for the Third Circuit (1982).

Holders of convertible debentures brought action against corporation and others alleging that corporation's failure to [934] give notice to debenture holders of dividend violated federal securities laws. The United States District Court for the Western District of Pennsylvania, William W. Knox, J., 509 F.Supp. 1002, entered judgment for defendants, and appeal was taken. The Court of Appeals, Gibbons, Circuit Judge, in an opinion announcing the judgment of the court, held that transaction which fixed same date as both date of declaration of and record date for participation in stock distribution to common stockholders was designed to deprive debenture holders of timely notice needed to exercise their conversion option and thus constituted manipulative or deceptive notice or contrivance in violation of statute prohibiting use of manipulative or deceptive devices or contrivances in connection with the purchase or sale of any security.

Affirmed in part and reversed and remanded in part.

Garth, Circuit Judge, concurred in part and concurred in judgment in an opinion.

Adams, Circuit Judge, filed a dissenting opinion.

1. Securities Regulation—64

Conversion option in convertible debentures qualified as contract for purchase or sale of security within meaning of statute which prohibits use of manipulative or deceptive devices or contrivances in connection with purchase or sale of any security. Securities Exchange Act of 1934, §10(b), 15 U.S.C.A. §78j(b).

Appendix C—Opinion of the United States Court of Appeals for the Third Circuit (1982).

2. Corporations—473
Securities Regulation—61

Under listing agreement, which imposed on corporation affirmative duties to give ten days' notice to stock exchange of record date for dividend and to afford holders of convertible debentures time to record interests and exercise conversion rights, parallel requirements of Securities and Exchange Commission Rule, Maryland law of fiduciaries obligations, and New York law of contracts, corporation had duty to speak and give timely notice to convertible debenture holders of proposed in kind dividend of stock in wholly owned subsidiary to common stock holders so that holders could convert before record date and participate in dividend. (Per Gibbons, Circuit Judge, with one Circuit Judge concurring in the result.) Securities Exchange Act of 1934, §10(b), 15 U.S.C.A. §78j(b).

3. Securities Regulation—117

Corporation and its directors, who decided to spin off wholly owned subsidiary to common stockholders while concealing transaction from holders of convertible debentures until it was too late for holders to participate by exercising conversion rights, and who knew that information about dividends was material and that cutting off conversion options would inure to benefit of majority stockholder, had scienter required by statute which prohibits use of manipulative or deceptive devices or contrivances in connection with purchase or sale of any security. Securities Exchange Act of 1934, §10(b), 15 U.S.C.A. §78j(b).

Appendix C—Opinion of the United States Court of Appeals for the Third Circuit (1982).

4. Securities Regulation—60

Violation of statute prohibiting use of manipulative or deceptive devices or contrivances in connection with the purchase or sale of any security does not require a specific intention to break the law; it requires only knowing or intentional acts which, objectively examined, amount to a violation. Securities Exchange Act of 1934, §10(b), 15 U.S.C.A. §78j(b).

5. Securities Regulation—117

Where corporation, majority stockholder, holding company and corporate directors knew materiality of concealed information concerning proposed dividend to common stockholders and intended consequences of concealment, advice of counsel that they would not incur liability did not constitute defense in action by holders of convertible debentures alleging violation of federal securities laws. Securities Exchange Act of 1934, §10(b), 15 U.S.C.A. §78j(b).

6. Securities Regulation—60

Action of corporation and directors in fixing one date as both date of declaration of and record date for participation in an in [935] kind dividend of stock in wholly owned subsidiary to common stockholders, which action was designed to deprive debenture holders of timely notice needed to exercise their conversion option if they should so desire, was a manipulative or deceptive device or contrivance in violation of the Securities Exchange Act. Securities Exchange Act of 1934, §10(b), 15 U.S.C.A. §78j(b).

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7. Securities Regulation—154

Holders of convertible debentures, who were victims of violation of statute which prohibits use of manipulative or deceptive devices or contrivances in connection with purchase or sale of security, were entitled to be heard about what remedy should be despite alleged speculative nature of award of money damages or difficulty in devising appropriate remedy. Securities Exchange Act of 1934, §10(b), 15 U.S.C.A. §78j(b).

Michael P. Malakoff (argued), Berger, Kapetan, Malakoff & Meyers, P. C., Pittsburgh, Pa., for appellants, Pittsburgh Terminal Corp. and Monroe Guttmann, Loretta Guttmann, Janet Rees and Evelyn Bittner.

Richard T. Wentley (argued), Anthony J. Basinski, Reed, Smith, Shaw & McClay, Pittsburgh, Pa., for appellees, The Baltimore & O. R. Co., The Chesapeake & O. R. Co. and Chessie System, Inc.

John J. Repcheck (argued), Gary F. Sharlock, David P. Helwig, Sharlock, Repcheck, Engel & Mahler, Pittsburgh, Pa., for appellees, W. James Price, Alonzo G. Decker, Jr., James Parker Nolan, Frederick Deane, Jr., James L. O'Keefe, Gregory S. Devine, Fay A. Le Fevre, Nicholas T. Camicia, Dr. Milton S. Eisenhower, Steven Muller, John K. Stevenson, Hays T. Watkins, Howard E. Simpson and Cyrus S. Eaton.

Ralph C. Ferrara, Gen. Counsel, Jacob H. Stillman, Associate Gen. Counsel, Gilbert Miller, Atty. Fellow, S.

Appendix C—Opinion of the United States Court of Appeals for the Third Circuit (1982).

Lee Terry, Jr., Atty., Securities and Exchange Com'n, Washington, D. C., for amicus curiae, Securities and Exchange Commission; Paul Gonson, Sol., Securities and Exchange Com'n, Washington, D. C., of counsel.

Before ADAMS, GIBBONS and GARTH, Circuit Judges.

OPINION ANNOUNCING THE JUDGMENT OF THE COURT

GIBBONS, Circuit Judge.

Pittsburgh Terminal Corporation, Monroe Guttmann, Loretta Guttmann, Evelyn Bittner and Janet Rees (the Bondholders), holders, prior to December 13, 1977, of convertible debentures issued by The Baltimore and Ohio Railroad Company (B & O), appeal from a final judgment dismissing their complaint, which charged that a dividend by the B & O on that date of stock of Mid-Allegheny Corporation (MAC) to B & O stockholders of record on that date violated the federal securities laws and the laws of several states. The defendants are B & O, a Maryland corporation, The Chesapeake & Ohio Railway Company (C & O), a Virginia corporation which on December 13, 1977, owned more than 99% of B & O's common stock, Chessie System, Inc. (Chessie), a Virginia corporation which is a holding company for C & O and its subsidiaries, and fourteen present or former directors of B & O. The convertible debentures owned by the Bondholders are B & O Series A, dated January 1, 1956 and maturing January 1, 2010, paying interest at 4.5%, and convertible at any time before maturity into 10 shares of B & O common stock for each $1000 of face

value. The action of which the Bondholders complain is the action of the defendants in fixing December 13, 1977, as both the date of declaration of, and the record date for participation in, the in kind dividend of MAC stock to B & O common stockholders. That action deprived debenture holders of the opportunity to convert before the record date and thereby participate in the dividend. The District Court held that it violated no legally protected rights of the debenture holders.[1] We reverse.

[936] I.

B & O owns and operates a railroad regulated by the Interstate Commerce Commission (ICC). Prior to the transactions giving rise to this lawsuit, B & O also owned substantial non-rail assets such as real estate, timber and mineral reserves. At one time both its common stock and its debentures were traded on the New York Stock Exchange (NYSE). When C & O acquired 99.63% of B & O's common stock, trading in that security ceased and it was delisted, although 13 individuals still held some shares. The NYSE listing of B & O's convertible debentures continued. No dividends were paid on the B & O common stock after 1961. Thus the holders of convertible debentures had no particular incentive to exercise the conversion privilege unless the no dividend policy were to change.

Because the regulations of the ICC prohibited a railroad corporation from engaging in non-rail business, B & O's and C & O's assets not used in rail

[1] The District Court decision is reported. *Pittsburgh Terminal Corp. v. Baltimore & Ohio R.R. Co.*, 509 F.Supp. 1002 (W.D.Pa.1981).

transportation remainded undeveloped. Beginning in 1973 when Chessie was formed, C & O began segregating its non-rail assets in a separate corporation, Chessie Resources, Inc., so that they could be developed free of constraints imposed by the ICC. The Chessie management desired to accomplish the same result with respect to B & O's non-rail assets. To that end, in January of 1977, the Chessie Corporation Restructuring Committee settled on a plan whereby the B & O would transfer those assets to MAC, a wholly owned B & O subsidiary, and then distribute the MAC stock as a dividend to B & O's fourteen common stockholders.

If, prior to the dividend in MAC stock, the number of B & O common stockholders were to increase substantially, B & O might have had to file a registration statement for MAC with the Securities and Exchange Commission (SEC). 15 U.S.C. §77f (1976). There were practical difficulties with the preparation of a registration statement, especially that of placing a value on B & O's non-rail assets. But if notice of the MAC transaction had been given to the convertible debenture holders prior to the record date of the in kind dividend, many of them might have elected to convert. Thus the Restructuring Committee concluded that the MAC transaction should be structured in such a way that the convertible debenture holders would not have such notice until after the record date. This, it was thought, would permit counsel for B & O to obtain from the SEC a no-action letter with respect to registration of the MAC stock.

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At the time the MAC transaction was under consideration, B & O had outstanding bond obligations under three trust indentures. One of these, a Convertible Income Bond Debenture, contained a provision requiring B & O to pay into a surplus income sinking fund an amount equal to any dividend. A second, the Refunding and General Mortgage Indenture, required that arrearages in the sinking funds had to be made up before a dividend could be paid. It was these provisions which had prevented B & O from paying dividends since 1961. The third Indenture was that governing the convertible debentures held by the Bondholders. In order to facilitate the dividend in MAC stock, B & O called for redemption the Convertible Income Bonds, and discharged the sinking fund arrearages on the Refunding and General Mortgage Indenture by paying the sinking funds approximately $7,000,000. These steps were accomplished by the summer of 1977. The Restructuring Committee then turned to the Indenture for the convertible debentures.

The convertible debentures also contained a redemption feature which in 1977 called for payment of a premium of 2.5% of their face amount. (344a). B & O did not elect to redeem. Conversion privilege features of the indenture oblige B & O to reserve sufficient common stock and to adjust for changes in par value. (350a). Conversion rights to the bondholders are protected in the event of merger or sale. (354a). Article V, section 12 of the Indenture provides:

> SECTION 12. The Company covenants and agrees that it will not declare and/or pay any dividend on its common stock payable in stock or create any

> rights to [937] subscribe for stock or securities convertible into stock unless in any such case notice of the taking of a record date for the determination of the stockholders entitled to receive such dividend, distribution or right is given at least ten days prior thereto by at least one publication in an Authorized Newspaper. A copy of each such published notice shall promptly after such publication be filed with the Trustee.

(357a). When the convertible debentures were issued in 1956, B & O entered into a listing agreement with the NYSE relating to them, which incorporated by reference B & O's earlier listing agreements. Listing Agreement A-12653 for an earlier bond issue, incorporated by reference in that for the 1956 convertible debenture issue, provides:

> 4. The Corporation will give the Exchange at least ten days' notice in advance of the closing of the transfer books, or of the taking of a record of its stockholders for any purpose.
>
> 5. The Corporation will publish promptly to the holders of any of its securities listed on the Exchange any action taken by the Corporation with respect to dividends or to the allotment of rights to subscribe or to any rights or benefits pertaining to the ownership of its securities listed on the Exchange; and shall give prompt notice to the Exchange of any such action; and shall afford the holders of its securities listed on the Exchange a proper period within which to record their interests and to exercise their rights; and shall issue all such

> rights in form approved by the Exchange and will make the same transferable, payable and deliverable in the Borough of Manhattan, in the City of New York.

(455a). In addition to the Listing Agreements, the B & O is bound by the Rules of the NYSE. Section A-2 of its Manual, "Timely Disclosure," provides:

> A corporation whose securities are listed on the New York Stock Exchange, Inc., is expected to release to the public any news or information which might reasonably be expected to materially affect the market for those securities. This is one of the most important and fundamental purposes of the listing agreement which each corporation enters into with the exchange.

509 F. Supp. at 1008.

In November of 1977, by which time impediments to the payment of dividends on B & O stock in the Convertible Income Bond Debenture and the Refunding and General Mortgage Indenture had been removed, plaintiff Monroe Guttmann wrote to the Secretary of B & O:

> As one of the very few public owners of B & O common stock, we are concerned that we may not be made aware of any dividend the directors declare on the common stock in sufficient time to convert any of our convertible debentures.
>
> Although it may not be customary to do so in view of the fact that declaration of a dividend may not be widely publicized, if publicized at all, we ask

> that you notify us promptly of any such dividend declaration so that we will have an opportunity to convert debentures in time to receive such dividend if we choose to do so.
>
> Will you please let me know what provisions there are in the by-laws of the company that govern the time which must elapse between the declaration of a dividend, the record date and the payable date.

(311a). To this pointed inquiry the Secretary, on November 17, 1977, replied:

> Thank you for your letter of November 11. We appreciate your concern as a holder of B&O Convertible Debentures as to whether B&O would fail to disclose the declaration of a dividend in its common stock.
>
> You may be assured that if B&O should have any information to announce regarding dividend action on B&O stock, such information will be disseminated promptly to the public at large. Because we cannot prefer you over the public at large advance advice cannot be sent to [938] you, but I will make sure that you get a copy of such press release. We are not in a position to help you with respect to your decision whether or not to convert.
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> There is no by-law provision relating to the timing of the declaration, record, and payment dates.

(312a). By the time of Guttmann's inquiry and the Secretary's reply, the Restructuring Committee's plan to structure the MAC transaction so as to avoid timely notice to the convertible bondholders was well advanced.

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Four in-house attorneys employed by B & O or C & O, one of whom was Chairman of the Restructuring Committee, examined the 1956 indenture and the New York Stock Exchange listing agreements. They concluded that the indenture required notice of stock dividends in B & O stock, but not of distributions of stock of subsidiaries. They concluded that that provision in the New York Stock Exchange listing agreement was inapplicable because it requires 10 days notice only with regard to dividends declared on listed stocks, and B & O common stock had been delisted. They concluded that under Maryland law, absent any action by the directors, the payment date of a dividend could be the same as the declaration date. The Restructuring Committee determined, therefore, to avoid giving notice to the convertible debenture holders. Their purpose in doing so was to prevent conversions which might require filing a registration statement for MAC stock.

The General Counsel of B & O retained the law firm of Hunton & Williams of Richmond, Virginia, to submit to the SEC a request for a no-action letter with respect to B & O's distribution of MAC shares. Prior to the time Hunton & Williams wrote to the SEC, the B & O Board of Directors met and adopted two resolutions. In the first resolution the Board authorized B & O's officers to convey a list of non-rail assets to MAC as a contribution to its capital. (409a). In the second, the Board resolved to distribute the MAC stock as a dividend to B & O shareholders. That resolution provides in part:

> RESOLVED, that the dividend on the Common Stock as specified in the next preceding resolution be payable on this date to shareholders of record at

> the close of business on this date; provided, however, that such payment shall be made by depositing such stock of Mid Allegheny Corporation with Mercantile Safe Deposit and Trust Company of Baltimore, Maryland, in trust, to be delivered to such shareholders of this Company on the earlier of the following dates, viz.: two days following the receipt of a letter from the Securities and Exchange Commission that it will take no action if the stock of Mid Allegheny Corporation is distributed to this Company's shareholders without registration under the provisions of the Securities Act of 1933; or two days following the date of an effective registration statement with respect to the stock of Mid Allegheny Corporation.

(417a). Thus actual delivery of the MAC stock certificates to shareholders was made contingent upon the obtaining of a no-action letter or the filing of a registration statement. It seems clear from the wording of the resolution that B & O intended to file a registration statement if it could not obtain a no-action letter, for the dividend declaration is unconditional.

Three days after B & O's dividend action, Hunton & Williams sent a request for a no-action letter to the SEC. (908a). That firm's December 16 letter to the Commission requested a no-action letter only with respect to a distribution of MAC stock to C & O and 13 individual B & O stockholders. It made no mention of the rights of convertible debenture holders. In its request Hunton & Williams opined that the distribution of MAC shares by B & O was not a sale within the meaning of section 2(3) of the Securities Act of 1933, 15 U.S.C. §77b(3).

Alternatively the firm suggested that if a sale were involved, the transaction was exempt under 17 C.F.R. §230.240 (1981). That SEC rule, issued pursuant to section 3(b), 15 U.S.C. §77c(b), exempts from registration certain securities of an issuer to fewer than 100 persons, provided [939] that restrictions on transferability are legended on the certificates. The no-action letter was not immediately forthcoming from the SEC, and on January 18, 1978, Hunton & Williams withdrew its reliance on 17 C.F.R. §230.240. (914a). Another written request was filed on June 29, 1979, relying solely on the contention that the dividend in MAC stock was not a sale. (915a). In September of 1979, long after the commencement of this lawsuit, the SEC issued a no-action letter "provided that MAC shares distributed to persons other than C & O are restricted as to transfer." The SEC letter noted that the District Court had by then entered an order that the defendants must hold at least 940 shares of MAC for tender to the convertible debenture holders if they prevailed. (919a).

II.

The first of these consolidated actions was commenced by Pittsburgh Terminal Corporation on December 28, 1977, and the others soon followed. On March 7, 1978 the District Court issued a preliminary injunction restraining the defendants from proceeding with the dividend in MAC stock.[2] Defendants appealed from that order, and when they agreed to hold sufficient shares of B & O and MAC stock to satisfy the claims of the convertible debenture holders, should they prevail, this court reversed that injunction.[3] The Bondholders sought

[2] 446 F.Supp. 656 (W.D.Pa.1978).

[3] Unpublished per curiam noted at 578 F.2d 1375 (3d Cir. 1978).

class action certification, which was denied as a result of an agreement between B & O and the Trustee under the 1956 indenture that should plaintiffs prevail, all debenture holders similarly situated will be accorded the treatment required by any judgment in plaintiffs' favor.[4] Motions for summary judgment in favor of the defendants were denied.[5] Thus the consolidated cases went to trial on amended complaints challenging the December 13, 1977 actions of the B & O Board of Directors. The complaints alleged that those actions violated section 10(b) of the Securities and Exchange Act, 15 U.S.C. §78j(b), the contractual rights of the convertible debenture holders under the provisions of the Indenture, their rights as third party beneficiaries of the NYSE listing agreements, the obligations of B & O under the rules of the NYSE, and the fiduciary duties of directors and of majority stockholders under Maryland law. The District Court, over defendants' objection, held that the convertible debenture holders had standing to make these claims, but rejected each of them. The court held that there was an insufficient showing of scienter for a section 10(b) violation; that section 6 of the Securities and Exchange Act of 1934, 15 U.S.C. §78f, does not permit private enforcement of the NYSE rules; that the listing agreements confer no rights on any party other than the NYSE; that the indenture does not

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[4] 509 F.Supp. at 1009.

[5] Summary judgment was granted in favor of three directors, Stephen Muller, Nicholas T. Camicia and Cyrus S. Eaton, who did not participate in the December 13 Board actions. 509 F.Supp. at 1004. That ruling is not appealed.

require notice of a dividend in stock of a subsidiary; and that the December 13, 1977 MAC transactions were entirely legal under Maryland law.[6] Without ruling definitively, the court also expressed doubts about what relief would be proper assuming liability had been established.

III.

A. *Purchase or Sale*

[1] Section 10(b) prohibits the use of manipulative or deceptive devices or contrivances "in connection with the purchase or sale of any security." The District Court held that a contract to obtain common stock in exchange for the surrender of a convertible debenture is a contract for purchase or sale of a security, and thus that the debenture holders could sue. Defendants chal-[940] lenge that holding. They place principal reliance upon *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 95 S.Ct. 1917, 44 L.Ed.2d 539 (1975). That case approved the earlier holding in *Birnbaum v. Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956, 72 S.Ct. 1051, 96 L.Ed. 1356 (1952), that only purchasers and sellers of securities could bring a private damage action under Section 10(b). While *Blue Chip Stamps v. Manor Drug Stores* holds that mere offerees may not sue under Section 10(b), the opinion of the Court carefully distinguishes the case of persons holding actual contractual rights to buy and sell securities. 421 U.S. at 749-50, 95 S.Ct. at 1931-1932. There is no indication that

[6] The court also dismissed Milton S. Eisenhower as a defendant because he did not participate in the December 13, 1977 Board meeting. 509 F.Supp. at 1018.

the Court intended to cast any doubt on the settled rule that a contract to buy or sell securities is a purchase or sale within the meaning of section 10(b), and that a party to such a contract has standing to sue for damages.[7] The indication is quite the contrary, for the Court observed:

> Unlike respondent, which had no contractual right or duty to purchase Blue Chip's securities, the holders of puts, calls, options and other contractual rights or duties to purchase or sell securities have been recognized as "purchasers" or "sellers" of securities for purposes of Rule 10b-5, not because of a judicial conclusion that they were similarly situated to "purchasers" or "sellers," but because the definitional provisions of the 1934 Act themselves grant them such status.

421 U.S. at 751, 95 S.Ct. at 1932.

Since we hold that the conversion option in a convertible debenture qualifies as a contract for the purchase or sale of a security, we need not reach the

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[7] *See, e.g., International Controls Corp. v. Vesco,* 593 F.2d 166, 181 n.18 (2d Cir.), *cert. denied,* 442 U.S. 941, 99 S.Ct. 2884, 61 L.Ed.2d 311 (1979); *Davis v. Davis,* 526 F.2d 1286, 1289 & n.4 (5th Cir. 1976); *Fenstermacher v. Philadelphia National Bank,* 493 F.2d 333, 336 n.4 (3d Cir. 1974); *Walling v. Beverly Enterprises,* 476 F.2d 393, 396 n.5 (9th Cir. 1973); *Green v. Hamilton Intern. Corp.,* 437 F.Supp. 723, 727 (S.D.N.Y.1977); *Camp v. Genesco,* [1976-77] Fed.Sec.L.Rep. (CCH) ¶95,679 at 90,336-37 (S.D.N.Y.1976). *But cf. Broad v. Rockwell International Corp.,* 614 F.2d 418 (5th Cir. 1980), *vacated upon rehearing en banc,* 642 F.2d 929 (5th Cir. 1981), *cert. denied,* 454 U.S. 965, 102 S.Ct. 506, 72 L.Ed.2d 380 (1981). If the vacated panel opinion in *Broad* can be read to suggest that the holder of a debenture containing a conversion option is not a purchaser or seller, we decline to follow it.

plaintiffs' alternative contention that the MAC dividend is a purchase or sale which would satisfy Section 10(b). *See International Controls Corp. v. Vesco*, 490 F.2d 1334, 1345 (2d Cir.), *cert. denied*, 417 U.S. 932, 94 S.Ct. 2644, 41 L.Ed.2d 236 (1974) (a dividend in kind of shares of a spun off corporation qualifies as a sale of securities).

B. *Duty to Speak*

[2] The Bondholders contend that by fixing the dividend date and the record date of the MAC dividend so as to prevent them from exercising their conversion option in time to participate in that dividend, the defendants violated section 10(b) and SEC Rule 10(b)-5(a) and (c), 17 C.F.R. 240.10b-5(a) and (c) (1981). It is undisputed that the defendants made a knowing decision to time the December 13, 1977 transactions so as to prevent the Bondholders from obtaining timely notice of them. Defendants contend that the decision was lawful because they made no affirmative misrepresentation and because they were under no affirmative obligation to speak.

In *Chiarella v. United States*, 445 U.S. 222, 228, 100 S.Ct. 1108, 1114, 63 L.Ed.2d 348 (1980), the Court observed that "one who fails to disclose material information prior to the consummation of a transaction commits fraud only when he is under a duty to do so." It held that a printer, who had no fiduciary obligation to a corporation or its shareholders, and who did not receive information as a result of the breach of any fiduciary relationship, could not be liable for a criminal violation of section 10(b). "He was not [the sellers'] agent, he was not

a fiduciary, he was not a person in whom the sellers had placed their trust and confidence." 445 U.S. at 232, 100 S.Ct. at 1116. The defendants contend that *Chiarella* requires an affirmance, because like the printer who happened upon material mar- [941] ket information, none of them had a duty to speak.

To put that contention in context, we note that the Bondholders were on December 13, 1977, holders of options to acquire B & O equity securities, while C & O was a majority holder of those securities having voting control of B & O. The convertible debentures were listed on the NYSE, and the listing agreement applicable to them imposed on B & O the affirmative duties (a) to give ten days notice to the Exchange of a record date for a dividend, and (b) to "afford the holders of its securities listed on the Exchange a proper period within which to record their interests and exercise their rights." These requirements of the listing agreement parallel those in SEC Rule 10b-17, which provides:

> (a) It shall constitute a "manipulative or deceptive device or contrivance" as used in section 10(b) of the Act for any issuer of a class of securities . . . to fail to give notice in accordance with paragraph (b) of this section of the following actions relating to such class of securities:
>
> (1) A dividend or other distribution in cash or in kind, except an ordinary interest payment on a debt security, but including a dividend or distribution of any security of the same or another issuer; . . .

17 C.F.R. §240.10b-17 (1981). B & O is the issuer of the convertible debentures, the MAC distribution is a

dividend of a security, and that dividend related to the convertible debentures since it was material to a decision about exercising the conversion option. The convertible debentures were not simple debt securities, for which the information about dividends ordinarily would not be material.

Whatever may be the fiduciary duty of majority stockholders and corporate directors under Maryland law to general unsecured creditors, we are here dealing with securities having an equity option feature. Maryland follows the settled rule that a control stockholder owes a fiduciary obligation not to exercise that control to the disadvantage of minority equity participants. *Cooperative Milk Service v. Hepner,* 198 Md. 104, 81 A.2d 219, 224 (1951). Similarly, Maryland directors must act as fiduciaries to all equity participants. *Coffman v. Maryland Pub. Co.,* 167 Md. 275, 173 A. 248, 254 (1934); *Lawson v. Baltimore Paint and Chemical Corp.,* 347 F. Supp. 967, 975 (D.Md. 1972). Although no Maryland case has been called to our attention presenting the precise issue of fiduciary obligations to holders of securities containing stock options, we would be very much surprised if Maryland or any other state would today hold that no such obligations were owed by an issuer of such securities and its directors. Moreover the scope of the obligation of the fiduciary depends upon the nature of the interest of the beneficiary. If the beneficiary of a fiduciary duty needs information in order intelligently to protect that interest, the withholding of it, especially when withholding it confers advantage upon others (in this case C & O and Chessie), is an obvious breach of duty.

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The 1956 Indenture under which B & O borrowed the sums evidenced by the convertible debentures was made in New York and the loan transaction completed there. B & O's obligation, therefore, is a New York contract. The law of that state is "that in every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract. . . ." *Kirke La Shelle Co. v. Paul Armstrong Co.*, 263 N.Y. 79, 87, 188 N.E. 163, 167 (1933). *See Van Gemert v. Boeing Co.*, 553 F.2d 812, 815 (2d Cir. 1977); Restatement (Second) of Contracts §205 (1981). Defendants in this case took steps to prevent the Bondholders from receiving information which they needed in order to receive the fruits of their conversion option should they choose to exercise it. As a matter of New York contract law, B & O had a duty to speak.

In the present context we do not look to the listing agreement. Rule 10b-17, the Maryland law of fiduciary obligations, and the New York law of contracts, as sources [942] of independent causes of action, though they well may be. Rather we look to them as sources of a duty to speak, breach of which under section 10(b) and Rule 10b-5(a) and (c) gives rise to a cause of action for fraud. Those four independent sources of duty to speak in the circumstances of this case amply serve, separately or collectively, to distinguish it from *Chiarella v. United States, supra.* We need not consider other sources of such duty relied on by the Bondholders.

C. *Scienter*

[3] The defendants urge that even if they were under a duty to speak, their decision not to do so in this instance did not involve the scienter required by the Supreme Court's interpretation of section 10(b). The District Court, relying on *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976), accepted this argument. It found that there was a legitimate business purpose in removing the non-rail assets from ownership and control of B & O[8]. That finding is not relevant, however, for what is complained of is not the formation of MAC or the decision to spin it off, but the decision to do both while concealing those steps from the Bondholders until it was too late for them to participate by exercising conversion rights if they chose to do so.

In this record, and indeed in the court's findings of fact, it is plain that the Restructuring Committee and B & O's Directors knew (1) that the information about the dividend in MAC shares, or information about any other dividend action after a lapse of sixteen years, was material to the Bondholders; (2) that cutting off conversion options would inure to the benefit of C & O, the majority stockholder; and (3) that the decision not to announce the dividend was intended to prevent timely exercise of the conversion privilege. The decision to time the MAC transaction so as to prevent notice to the Bondholders until too late was both knowing and intentional. No more is required by the governing cases.

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[8] 509 F.Supp. at 1012-13.

Aaron v. Securities and Exchange Commission, 446 U.S. 680, 690, 100 S.Ct. 1945, 1952, 64 L.Ed.2d 611 (1980); *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 197, 96 S.Ct. 1375, 1382, 47 L.Ed.2d 668 (1976); *Cramer v. General Telephone & Electronics Corp.,* 582 F.2d 259, 273 (3d Cir. 1978), *cert. denied,* 439 U.S. 1129, 99 S.Ct. 1048, 59 L.Ed.2d 90 (1979). *Cf. McLean v. Alexander,* 599 F.2d 1190, 1197 (3d Cir. 1979).

The defendants insist that despite their intention to prevent timely exercise of conversion rights prior to the MAC dividend, they lacked the necessary scienter as a matter of law for two reasons. First, they contend, they had a valid business purpose in cutting off conversion rights in that they desired to avoid having to file a registration statement for MAC stock. This is a business reason, certainly, but not a valid one. Of course, the removal of non-rail assets from the reach of the conversion privilege, and the avoidance of the expense of preparing and fling a registration statement, was good business for some of the interested parties. Clearly, however, it was bad business for the Bondholders. Any manipulative act or practice can be justified by focusing only on the business purpose of the side of the transaction which benefited from it.

[4, 5] Defendants' second contention is that their reliance on the advice of counsel employed by B & O and C & O is a complete defense. In this case it is not. A violation of section 10(b) does not require a specific intention to break the law. It requires only knowing or intentional actions which, objectively examined, amount to a violation. *See Securities and Exchange Commission v. Falstaff Brewing Corp.,* 629 F.2d 62, 77 (D.C.Cir.),

cert. denied sub nom. Kalmanovitz v. Securities and Exchange Commission, 449 U.S. 1012, 101 S.Ct. 569, 66 L.Ed.2d 471 (1980); *Arthur Lipper Corp. v. Securities and Exchange Commission,* 547 F.2d 171, 181 (2d Cir. 1976), *cert. denied,* 434 U.S. 1009, 98 S.Ct. 719, 54 L.Ed.2d 752 (1978). Advice of counsel may bear upon [943] scienter in some cases: where, for example, directors rely upon counsel to conduct a factual investigation of the truth of information to be released; or where counsel mistakenly but in good faith represent that some information is either immaterial or clear. In such instances the defendants may not have an appreciation of the consequences of their conduct. But where, as here, they know the materiality of the concealed information and intend the consequences of concealment, advice of counsel that they will not incur liability cannot be recognized as a defense. The court, not counsel, must make that ultimate legal determination.

On the facts as found, therefore, the District Court erred in ruling that the defendants lacked the scienter required for a section 10(b) violation.

[6] We hold, therefore, that on the facts found by the District Court, the December 13, 1977 transaction, designed to deprive the Bondholders of timely notice in order to exercise their conversion option if they should so desire was a manipulative or deceptive device or contrivance in violation of section 10(b).[9]

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[9] The court's finding that Milton D. Eisenhower did not participate in the December 13, 1977 meeting is not clearly erroneous; indeed it is not challenged. Thus the judgment in his favor must be affirmed.

IV.

Our holding in Part III requires a reversal. The Bondholders also contend that they proved a breach of the Indenture, a claim as a third party beneficiary for breach of the listing agreement and breaches of fiduciary duty under Maryland law. In the District Court they pleaded, as well, a cause of action under section 6 of the Securities and Exchange Act of 1934, 15 U.S.C. §78f, for violation of the NYSE rules. They do not suggest, however, that the relief available under section 10(b) is less extensive than would be available under these alternative legal theories. Since it appears that no different remedies would be available were we to decide in the Bondholders' favor on those alternative legal theories, there is no reason to address them.

V.

[7] As a separate ground for affirmance, the defendants urge that the Bondholders failed to prove damages and have not to date exercised their conversion option. Obviously the Bondholders could not be expected to exercise a conversion option until they knew whether or not they were entitled to participate in the distribution of MAC stock. As to the speculative nature of the award of money damages, the difficulty arises out of B & O's conscious choice to avoid making an evaluation of the B & O assets transferred to MAC as a contribution to capital. The District Court speculated that devising an appropriate remedy might be difficult. So it may be, but the Bondholders were the victims of a section 10(b) violation, and they are entitled to be heard about what the remedy should be. Since the District

Court did not rule on the matter of relief, nothing is before us on that aspect of the case which we can intelligently review. A remand is required so that the trial court can fashion an appropriate remedy for the violation we have found.

VI.

Except for the judgment in favor of Milton D. Eisenhower, the judgment in favor of the defendants will be reversed, and the case remanded for a determination of appropriate relief.

GARTH, Circuit Judge, concurring in part and concurring in the judgment.

I agree that the judgment of the district court must be reversed. However, in concluding that the defendants violated Rule 10b-5, 17 C.F.R. §240.10b-5 (1981), I would predicate their duty to disclose the Mid-Allegheny Corporation (MAC) dividend solely on the provisions of Rule 10b-17, 17 C.F.R. §240.10b-17 (1981), rather than on the complex of theories set forth in Part III-B of Judge Gibbons' opinion. I thus [944] would not reach the question whether the defendants had a duty to disclose under the New York Stock Exchange (NYSE) listing agreement, the Maryland law of fiduciary obligations, or the New York law of contracts.

Appendix C—Opinion of the United States Court of Appeals for the Third Circuit (1982).

I.

Rule 10b-17 provides that the failure of an issuer to give ten days' prior notice of the declaration of a dividend *relating to* a publicly traded security constitutes a "manipulative or deceptive device or contrivance" within the prohibitions of section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b)(1976).[1] Here, it is undisputed that while the

[1] The Rule states:

(a) It shall constitute a "manipulative or deceptive device or contrivance" as used in section 10(b) of the Act for any issuer of a class of securities publicly traded by the use of any means or instrumentality of interstate commerce or of the mails or of any facility of any national securities exchange to fail to give notice in accordance with paragraph (b) of this section of the following actions *relating to* such class of securities:

(1) A dividend or other distribution in cash or in kind, except an ordinary interest payment on a debt security, but including a dividend or distribution of any security of the same or another issuer;

* * * * * * *

(b) Notice shall be deemed to have been given in accordance with this section only if:

(1) Given to the National Association of Securities Dealers, Inc., no later than 10 days prior to the record date involved or, in case of a rights subscription or other offering if such 10 days advance notice is not practical, on or before the record date and in no event later than the effective date of the registration statement to which the offering relates. . . . [or]

* * * * * * *

(3) Given in accordance with procedures of the national securities exchange or exchanges upon which a security of such issuer is registered pursuant to section 12 of the Act which contain requirements substantially comparable to those set forth in paragraph (b)(1) of this section.

17 C.F.R. §240.10(b)-17 (1981) (emphasis added).

common stock of the Baltimore & Ohio Railroad Company was not publicly traded or listed on any national securities exchange (99.63 percent of the common stock was owned by the Chesapeake & Ohio Railway Company), the convertible debentures were publicly traded and were listed on the NYSE. Thus, the B & O convertible debentures are a publicly traded class of securities within the meaning of Rule 10b-17.[2] It is also undisputed that the B & O failed to give ten days' notice of its action in declaring the MAC stock dividend to the National Association of Securities Dealers (NASD), or to the NYSE in accordance with the procedures set forth in the B & O's listing agreement with that Exchange.[3] Thus, the only remaining question

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[2] Rule 10b-17 is not limited to equity securities. That dividends or other distributions relating to debt securities are covered by the Rule is evident from the Rule's exclusion from its notice requirement of "ordinary interest payment[s] on a debt security." Rule 10b-17(a)(1). This clearly indicates that dividends or other distributions relating to debt securities, other than ordinary interest payments, are governed by the Rule. If Rule 10b-17 covers equity and debt securities, it must cover a mixed debt-equity security such as a convertible debenture.

[3] The NYSE listing agreement for the debentures, App. at 457a, entered into by the B & O on March 22, 1956, incorporates by reference an earlier listing agreement between the B & O and the NYSE, dated February 18, 1947. That earlier agreement provided:

> The Corporation [B & O] will give the Exchange at least ten days' notice in advance of the closing of the transfer books, or of the taking of a record of its stockholders for any purpose.
>
> The Corporation will publish promptly to the holders of any of its securities listed on the Exchange any action taken by the Corporation with respect to dividends or to the allotment of rights to subscribe or to any rights or benefits pertaining to the ownership of its securities listed on the Exchange; and shall give prompt notice to the Exchange of any such action; and shall afford the holders of its securities listed on the Exchange a proper period within which to record their interests and to exercise their rights. . . .

(Footnote continued on following page)

to be answered is whether the declaration of the MAC dividend was an action "relating to" the publicly traded con- [945] vertible debentures within the meaning of Rule 10b-17. If Rule 10b-17 applies, a duty of disclosure arises, the breach of which provides the predicate for a violation of Rule 10b-5. *See generally Chiarella v. United States,* 445 U.S. 222, 235, 100 S.Ct. 1108, 1118, 63 L.Ed.2d 348 (1980).[4]

II.

The defendants argue that the notice requirements of Rule 10b-17 apply only to dividends declared on publicly listed stock. Because the B & O's common stock was not publicly listed, the defendants argue, no notice was therefore mandated.

In my opinion, this argument contemplates too restrictive a reading of Rule 10b-17. The Rule was meant to protect the ability of investors to exercise their investment rights to the fullest. It does so by operating to ensure that opportunites to exploit benefits associated with security ownership will not be lost by the withholding of material information. As the SEC explained when it proposed Rule 10b-17, in the absence of disclosure of imminent dividend declarations,

(Footnote continued from preceding page)

Id. at 455a. By its terms, the NYSE listing agreement unquestionably includes any action taken, including the declaration of dividends, which affects convertible debentures.

[4] Thus, we need not decide whether a violation of Rule 10b-17, like a violation of Rule 10b-5, 17 C.F.R. §240.10b-5 (1981), itself gives rise to an implied right of action for damages under §10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b) (1976).

"purchasers and their brokers may have entered into and settled securities transactions without knowledge of the accrual of such rights and were thus unable to take necessary steps to protect their interests." Securities Exchange Act Rel. No. 9076, 36 Fed.Reg. 3430 (Feb. 17, 1971).

While it is true that the Rule makes no specific reference to convertible debentures as such, it without question includes such instruments within its classification of "securities publicly traded" and proscribes the failure to give notice of dividends "relating to such class of securities." *See* note 2 *supra*. I agree with the SEC that

> [f]or purposes of determining what information is material to security holders, there is a significant difference between the holders of simple debt securities and the holders of debt securities convertible into stock. The latter own contracts to purchase the stock on specified terms and at a specified price and, as a result, have as great an interest in material facts concerning that stock as do the stockholders.

SEC Amicus Brief at 19 n.17.

It is obvious that a stock dividend declared on common stock comes within the terms of Rule 10b-17. It would be anomalous if a stock dividend which becomes payable simply by the exercise of converting a debenture were not considered as "relating to such class of [convertible debenture] securities." It seems to me that in the context of Rule 10b-17, a dividend "relates to" a security if the declaration of that dividend makes the

security significantly more or less valuable, whether by directly increasing or decreasing the value of the security or by enabling the holder of the security to take steps which would either augment the security's worth or prevent the diminution of its value.

Here, the convertible debentureholders claim that the value of the non-rail assets of the B & O which are represented by the MAC dividend roughly approximates $250 million. Prior to the declaration of the MAC dividend, the debentures included the right to convert to B & O common stock which represented both rail and non-rail assets; after the dividend declaration, the debentures were convertible into B & O common stock which no longer represented the non-rail assets and *only* represented the rail assets. Tested by the definition set out above, it is evident to me that the declaration of such a dividend in which the convertible debentureholders could share in both categories of assets by exercising their conversion option, is an action which clearly "relates to" this class of securities.

Accordingly, I agree with Judge Gibbons, who has reached a similar conclusion in his opinion where he has indicated that the MAC dividend "related to the convertible debentures since it was material to a decision about exercising the [debentures'] con- [946] version option." Op. of Gibbons, J., at 941. Under the analysis I have suggested, the defendants had a duty under Rule 10b-17 to give advance notice to the NASD or the NYSE (and through them to the convertible debentureholders) of the declaration of the MAC dividend. The conceded failure of the defendants to give such notice rendered them liable in damages under Rule 10b-5. That being the

case, there is no need to consider whether any other theory is viable which would impose a duty upon the defendants to give notice to the holders of the convertible debentures.

Accordingly, I join Judge Gibbons' opinion except for Part III-B, and concur in the reversal of the judgment below.

ADAMS, Circuit Judge, dissenting.

The Supreme Court recently has made clear that liability for nondisclosure of material information under the federal securities laws cannot be imposed absent a duty to speak. *Chiarella v. United States,* 445 U.S. 222, 235, 100 S.Ct. 1108, 1118, 63 L.Ed.2d 348 (1980). Aware of this precept, Judge Gibbons has pointed to no fewer than four possible sources from which to derive a duty, on the part of The Baltimore and Ohio Railroad, to notify its convertible debenture holders prior to the declaration of the MAC dividend. Judge Garth, concurring, has limited the duty analysis solely to the provisions of Rule 10b-17; the holding of the Court, therefore, rests on that narrow ground. Unlike my two colleagues, I conclude that B & O was under no legal obligation—pursuant to Rule 10b-17 or otherwise—to provide plaintiffs with advance notice of the MAC dividend. I therefore respectfully dissent.

I.

Convertible debentures frequently are characterized as "hybrids," embodying the attributes of both debt and equity securities. *See, eg., Broad v. Rockwell International Corp.,* 642 F.2d 929, 940 (5th Cir.)(en banc),

cert. denied, 454 U.S. 965, 102 S.Ct. 506, 72 L.Ed.2d 380 (1981); American Bar Foundation, *Commentaries on Indentures* 523 (1971); Note, Hoff *and* Harff: *Does the Convertible Debenture Holder Have Standing to Maintain a Shareholder Derivative Action?*, 26 Syracuse L.Rev. 730, 751 (1975). As such, they have proven to be an attractive and effective means of corporate financing. Like most debt securities, convertible debentures provide a fixed rate of return and assure the investor priority, over common shareholders, in claims on the issuer's assets. Should the market price of the common stock rise, however, the debentureholder may exercise an option to convert the debt security into shares of common stock. "Thus there is the opportunity to benefit from a rise in stock prices from the comparative safety of a debt . . . position." Katzin, *Financial and Legal Problems in the Use of Convertible Securities,* 24 Bus. Law. 359, 361 (1969).

From the corporation's standpoint, the issuance of convertible debentures can be similarly advantageous. Primarily, the convertible securities provide a way to raise new capital indirectly—by permitting management " 'to raise funds today at tommorow's higher common stock prices.' " Fleischer & Cary, *The Taxation of Convertible Bonds and Stock,* 74 Harv.L.Rev. 473, 474 (1961) (quoting Pilcher, *Raising Capital with Convertible Securities* 61, 138 (1955)). In addition,

> the new funds will be contributing to income by the time the debentures are converted. In the interim, while the company is putting the new money effectively to work, the charge takes the form of interest—deductible for tax purposes—rather than a

> reduction in income per share. Thus the dilution of earnings which traditionally accompanies an equity issue is deferred until the firm is making more money.

Id. (footnote omitted). Finally, because the conversion feature is so attractive to investors, the issuer can often offer the debentures at an interest rate lower than that required on other debt securities. Katzin, *supra*, at 362. *But see* Klein, *The Convertible Bond: A Peculiar Package*, 123 U.Pa.L.Rev. 547, 558-59 (1975) (referring to this rationale as "flimflam").

[947] Whatever financial advantages attach to the issuance or purchase of convertible debentures, the legal status of these hybrid securities remains inherently complex. As debt securities, the debentures impose a specific set of obligations on the corporation—namely, the regular payment of interest and the repayment of principal upon maturity. As equity securities, in contrast, the debentures may require a broader range of duties from the issuer. The difficulty lies not in the characterization of the debenture as *either* debt or equity—for it is both—but in determining, in each case, the extent to which the investor is owed rights and remedies beyond those commonly accorded debt holders.[1]

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[1] *See Green v. Hamilton Int'l. Corp.*, No. 76 Civ. 5433 (S.D.N.Y. July 14, 1981) ("If the wrongs alleged in this case impacted upon the securities so as to undermine the debtor-creditor relationship, a contract analysis is appropriate, and plaintiffs ... were owed no special duty outside the bounds of the contract. If the wrongs alleged impinged upon the equity aspects, then the analysis would more properly treat plaintiffs like shareholders to whom the majority shareholders and directors of a corporation owe a duty of 'honesty, loyalty, good faith and fairness.' ").

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The traditional view is that the convertible debenture holder is a mere creditor until conversion, whose relationship with the issuing corporation is governed by contract and statute. In an early Massachusetts decision, for example, the court rejected a convertible note holder's claim that he had an equitable interest in newly-issued shares of stock. *Pratt v. American Bell Telephone Co.*, 141 Mass. 225, 5 N.E. 307 (1886). The plaintiff was "in no sense a stockholder," declared the court; his "rights and interest as a stockholder of the corporation were postponed to the time when he made his option and demanded his stock. Pending this time, the contract gave him the right to payment of the coupons attached to the notes, and nothing more." 5 N.E. at 311.

Several years later, Justice Holmes expanded upon this principle, holding for the Supreme Court of Massachusetts that the debenture holder had no right, apart from contract, to object to corporate actions that dilute or destroy the value of the conversion option:

> [the option] imposes no restriction upon the obligor in regard to the issue of new stock, although the issue may be upon such terms as to diminish the value of the right. It leaves the management of the company in accordance with its other interests unhampered. It is simply an option to take stock as it may turn out to be when the time for choice arrives. The bondholder does not become a stockholder, by his contract, in equity any more than at law. . . .

> . . . [T]he contract does not prevent the corporation from consolidating with another in such a way as to make performance impossible, any more than it prevents the issue of new stock in such a way as to make performance valueless.

Parkinson v. West End St. Ry. Co., 173 Mass. 446, 53 N.E. 891, 892 (1899). *See also Gay v. Burgess Mills*, 30 R.I. 231, 74 A. 714 (1909). And in *Lisman v. Milwaukee, L. S. & W. Ry. Co.*, 161 F. 472 (E.D.Wis.1908), *aff'd.* 170 F. 1020 (7th Cir. 1909), the court held that convertible debenture holders could not complain when the railroad company in which they had invested merged with another railroad. The fact that the parties "were bound to" have anticipated such a consolidation when they entered into the option contract was dispositive.

The rights and remedies of convertible debenture holders have expanded since the turn of the century. Most notably, the Securities Exchange Act of 1934 accords convertible debenture holders the federal statutory rights of "equity security holders,"[2] able, for example, to employ section 10(b) of the Act to protect against fraud or manipulative devices. 15 U.S.C. §78j. Congress's explicit recognition of converti- [948] bles as equity, as well as debt, securities has had significant consequences. In *Kusner v. First Pennsylvania Corp.*, 531 F.2d 1234 (3d Cir. 1976), for instance, this Court held that a convertible debenture holder, who alleged that he

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[2] The Act defines the term "equity security" broadly to include "any stock or similar security; or any security convertible, with or without consideration, into such a security. . . ." 15 U.S.C. §78c(11). *See Chemical Fund, Inc. v. Xerox Corp.*, 377 F.2d 107, 110 (2d Cir. 1967); *In re Will of Migel*, 71 Misc.2d 640, 336 N.Y.S.2d 376, 379 (1972).

had purchased the securities in reliance on a false and misleading prospectus, had standing to sue under section 10(b). *Kusner* depicts the precise sort of situation in which a section 10(b) remedy is appropriate for debenture holders in their role as equity investors. As the Court explained, in such a case, the debenture holder's need for accurate information about the corporation was as pressing as any shareholder's:

> If during the conversion period the value of the common stock (a function of its market price and dividend position) greatly exceeds the value of the fixed payment and interest obligation, a holder probably will exercise the conversion privilege. The possibility that the value of common stock will increase to a point where it exceeds the value of the bond is the sales feature with which the issuer obtained a lower-than-market interest rate on the bond. Thus . . . a misrepresentation in the prospectus that would be material to a stock purchaser would be material to a convertible bond purchaser. The convertible bond purchaser may well have been defrauded of the interest differential.

531 F.2d at 1238 (footnote omitted).

The mere availability of a securities act remedy for fraud, however, does not answer the question whether the common law rule of *Parkinson* remains the applicable standard by which to judge whether or not a corporation has, indeed, acted fraudulently. That question was addressed and analyzed perceptively in a recent en banc Fifth Circuit decision, *Broad v. Rockwell International Corp.*, 642 F.2d 929 (5th Cir.), *cert. denied*, 454 U.S. 965,

102 S.Ct. 506, 72 L.Ed.2d 380 (1981). There, the plaintiff debenture holders complained that when the company in which they had invested was acquired by another entity in a cash merger, they lost their right to convert into common stock. The Court concluded that the plaintiffs had "received . . . all to which they were contractually entitled under the Indenture" and that, as a result, no violation of section 10(b) could have occurred:

> There is no doubt but that there was concerted, intentional conduct by the defendants to bring about [the] result [about which plaintiffs complain]. But as a matter of law, there was no violation of section 10(b) or Rule 10b-5 because there was no fraud. "Section 10(b) is aptly described as a catch-all provision, but what it catches must be fraud." *Chiarella v. United States,* 445 U.S. 222, 234-35 [100 S.Ct. 1108, 1117-1118, 63 L.Ed.2d 348], . . . (1980) (criminal prosecution under section 10(b) and rule 10b-5). It is elementary that section 10(b) and Rule 10b-5 reach only conduct involving manipulation or deception. *E.g., Santa Fe Industries, Inc. v. Green,* 430 U.S. 462 [97 S.Ct. 1292, 51 L.Ed.2d 480], . . . (1977); *Ernst & Ernst v. Hochfelder,* 425 U.S. 185 [96 S.Ct. 1375, 47 L.Ed.2d 668], . . . (1976). The defendants' conduct involved neither; they merely carried out their contractural obligations. As a conceptual matter, they could not have fraudulently schemed to deprive the holders of Debentures of a right that those holders did not in fact have.

642 F.2d at 963.

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Virtually every modern commentator appears to agree with the *Broad* court that convertible debenture holders have no cause to complain about legal corporate conduct that adversely affects the value of the conversion option unless such conduct has been explicitly proscribed or otherwise addressed in the debenture indenture.[3] As explained by the American Bar foundation:

> [949] Inasmuch as ownership of a convertible debenture does not give the holder the rights of a shareholder, the holder of a convertible debenture would have almost no protection against acts by the Company which would adversely affect the value of the common stock issuable on conversion, such as split-up of shares, stock dividends, distribution of assets, issuance or sale of other convertible securities, issuance of options, issuance of sale of common stock at prices below the current conversion or market price, merger, sale of assets or dissolution and liquidation of the Company. Events of this type are customarily described as "diluting" the value of the conversion privilege, *and if protection is desired against such dilution, appropriate provisions must be included in the indenture.*

[3] The "indenture" is the document that sets forth the terms under which the debenture has been issued, including the redemption rights of the issuer, the conversion rights of the investor, and any number of administrative or procedural provisions. The indenture is usually conceived of as a contract between the issuer and a trustee for the benefit of the debenture holders. *See generally* Commentaries, *supra* at 7-8. Since 1939, debenture holders have been protected by federal law against breaches of fiduciary duty by the trustee. Trust Indenture Act of 1939, 15 U.S.C. §§77aaa *et seq.* (1976). *See Zeffiro v. First Penn. Banking and Trust Co.*, 473 F.Supp. 201 (E.D.Pa.1979), *aff'd.*, 623 F.2d 290 (3d Cir. 1980).

Commentaries, *supra*, at 527 (emphasis added) (footnote omitted). *See also Broad v. Rockwell International Corp.*, *supra* at 943; *Kessler v. General Cable Corp.*, 92 Cal.App.3d 531, 155 Cal.Rptr. 94, 99-100 (1979); 6A *W. Fletcher Cyclopedia of the Law of Private Corporations* §§2694-2694.1 (perm.ed. 1981). such so-called "anti-dilution clauses" are thus among the most important of the various contract provisions that can be negotiated between the issuing corporation and the debenture holders or their representatives.[4] Commonly, they require the corporation to give the debenture holder advance notice of specific acts that may erode or destroy the conversion option, so that the investor can convert, if he so chooses, prior to the act in question. Alternatively, the anti-dilution clause can provide for the adjustment of the conversion price to reflect the change in value. *See* Irvine, *Some Comments Regarding "Anti-Dilution" Provisions Applicable to Convertible Securities*, 13 Bus.Law. 729 (1958). Less frequently, the anti-dilution

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[4] *See* Hills, *Convertible Securities—Legal Aspects and Draftsmanship*, 19 Calif.L.Rev. 1, 1-2 (1930) ("Poor draftsmanship and a disregard of possible corporate changes, rather than a general misunderstanding of the conversion privilege, may be set down as the principal causes of litigation on this subject. The decisions resulting from such litigation have acted as danger signals, attorneys have become more careful and litigation has been reduced to a minimum.") Kaplan, *Piercing the Corporate Boilerplate: Anti-Dilution Clauses in Convertible Secutities*, 33 U.Chi.L.Rev. 1, 29 (1965) ("The anti-dilution clause is an integral and necessary part of any convertible security. The clause is a complex, difficult and intriguing exercise in corporate draftsmanship. It requires the draftsman to protect against the whole gamut of potential corporate rearrangement or manipulation which might adversely affect the rights of the holders of the convertible securities. So intricate and precise an instrument should be prepared with the greatest care and diligence.").

provision is drafted to prohibit the corporation from taking certain actions that may cause diminution in the value of the conversion option. *See* Commentaries, *supra*, at 527-28.

The conduct at issue in the present case—namely, the transfer of B & O's non-rail assets to MAC and the distribution of the MAC stock to B & O's common shareholders—is clearly of the sort that could have been addressed by the inclusion of an appropriate anti-dilution provision within the indenture. Such a provision could have taken any number of forms. In its Commentaries on the Model Debenture Indenture provisions, for instance, the American Bar Foundation noted that "[w]hen dividends are declared and paid other than in shares of common stock or as normal cash dividends," the debenture holder's conversion rights can be protected against dilution "by providing for a reduction of the conversion price to reflect the diminution of the corporate assets resulting from such dividends." Commentaries, *supra*, at 529. Moreover, the Bar Foundation continued, "[i]t is sometimes provided that, upon exercise of his conversion rights, the debentureholder shall receive, in addition to the shares to which he is entitled, the amount of assets (or a sum equal to the value thereof) which would have been distributed to him if he had exercised his right to convert immediately prior to the record [950] date for

such distribution." *Id.*[5] And at least one commentator has suggested that it is advisable to insert in the indenture a provision giving holders of convertible securities adequate notice in the event that "the Company shall propose . . . to pay any dividend payable in stock of any class to the holders of its Common Stock *or to make any other distribution to the holders of its Common Stock (other than a cash dividend payable out of earnings or earned surplus legally available for the payment of dividends . . .).*" Kaplan, *supra* note 4, at 13

[5] The model indenture discussed in the *Commentaries* includes at least two provisions that address this point. One stipulates, for example, that:

> In the event that the Company shall make *any distribution of its assets* upon or with respect to its Common Stock, as a liquidating or partial liquidating dividend, *or other than as a dividend payable out of earnings or any surplus legally available for dividends* under the laws of the state of incorporation of the Company, each Holder of any Debenture then Outstanding shall, upon the exercise of his right to convert after the record date for such distribution, or, in the absence of a record date, after the date of such distribution, receive, in addition to the shares subscribed for, the amount of such assets (or, at the option of the Company, a sum equal to the value thereof at the time of distribution as determined by the Board of Directors in its sole discretion) which would have been distributed to such Holder if he had exercised his right to convert immediately prior to the record date for such distribution, or, in the absence of a record date, immediately prior to the date of such distribution.

Commentaries, supra, at 547 (emphasis added) (footnote omitted). An alternate provision, addressing the situation in which the corporation distributes to its shareholders "evidences of its indebtedness or assets" excluding dividends paid out of earned surplus, declares that "in each such case the Conversion Price shall be adjusted" to compensate for the distribution of the corporation's assets to its shareholders. *Id.* at 553.

n.24 (emphasis added). Such a notice provision would clearly encompass the kind of arrangement against which Pittsburgh Terminal has complained in the case at bar.

Significantly, although the commentators have been careful to consider the situation in which a corporation distributes its assets in forms other than ordinary cash or stock dividends, the indenture at issue here contains no such provision. While the indenture does address a variety of potentially diluting acts—including a change in the par value of the outstanding common stock; a change of outstanding common stock from par to no par; and a possible consolidation, merger, or sale of the company—we have been directed to no provision in the indenture here that addresses the situation in which the company spins off a portion of its assets to a subsidiary and distributes those assets, in the form of a stock dividend, to its common shareholders. Plaintiffs are able to point to only one section in the indenture that is even arguably apposite. That provision, entitled "Notice to be Given of Record Date for Stock Dividend, etc.," provides that:

> The Company covenants and agrees that it will not declare and/or pay any dividend on its common stock *payable in stock* or create any rights to subscribe for stock or securities convertible into stock unless in any such case notice of the taking of a record date for the determination of the stockholders entitled to receive such dividend, distribution or right is given at least ten days prior thereto by at least one publication in an Authorized Newspaper.

Indenture Article 5, Section 12 (appendix at 357a) (emphasis added).

Plaintiffs assert that the term "stock dividend" in the table of contents, as well as the words "payable in stock," which are found in the body of the provision, suggest that the clause is "in no way limited to the common stock of the B&O," but, rather, applies to distributions of MAC stock as well. Brief of Appellant at 34. Plaintiffs also contend that, even assuming the phrase "payable in stock" refers only to B&O common stock, the provision violates the New York[6] requirement of fair dealing. I find neither of these two arguments convincing.

[951] It is a well-established principle of New York corporate law that a "stock dividend" is "any dividend payable in stock of *the corporation declaring or authorizing such dividend.*" *In re Fosdick's Trust,* 4 Misc.2d 1003, 147 N.Y.S.2d 509, 514 (1955) (emphasis added), *aff'd.,* 3 App.Div.2d 1000, 165 N.Y.S.2d 429 (1957), *aff'd.,* 4 N.Y.2d 646, 176 N.Y.S.2d 966, 152 N.E.2d 228 (1958); 11 *W. Fletcher Cyclopedia of the Law of Private Corporations* §5359 (perm. ed. 1971). The declaration of such a dividend generally is conceived of as a capitalization of surplus, which neither depletes the assets of the corporation nor increases the holdings of the stockholder. *See Gibbons v. Mahon,* 136 U.S. 549, 559-60, 10 S.Ct. 1057, 1058-1059, 34 L.Ed. 525 (1890); *Equitable Trust Co. v. Prentice,* 250 N.Y. 1, 164 N.E. 723, 725 (1928) (Cardozo, C. J.) ("When a dividend is paid in cash, the ownership of the corporate assets is changed; the company owns less, and the shareholder owns more,

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[6] As Judge Gibbons notes, the B&O indenture was entered into in New York and must be construed under the laws of that state. At 941.

or something essentially different, though its value be no greater. Upon the distribution of a stock dividend, ownership of the assets is precisely as it was. 'A stock dividend does not distribute property, but simply dilutes the shares as they existed before.' "). Thus stock dividends traditionally have been distinguished "from [dividends] payable in the stock of a subsidiary" or another independent corporation. *Id. see also Kellogg v. Kellogg*, 166 Misc. 791, 4 N.Y.S.2d 219, 221, *aff'd.*, 254 App.Div. 812, 5 N.Y.S.2d 506 (1938). The latter sort of dividend—stock in subsidiaries or other corporations—is considered the equivalent of a cash dividend—"diminish[ing] the property of the corporation by exactly the amount paid out and correspondingly increas[ing] the property of the individual stockholders. . . ." 11 *W. Fletcher Cyclopedia of the Law of Private Corporations* §5355 (perm. ed. 1971) (footnote omitted).

Applying these precepts to the case at hand, it is clear that the distribution of the MAC stock was *not* a "stock dividend," as that term traditionally has been defined. B & O was not capitalizing surplus; it was divesting itself of a considerable portion of its assets. In practical terms, the effect of the MAC dividend was no different than if B & O had sold its non-rail assets for cash and then distributed an extraordinary cash dividend to its shareholders.[7] *See Venner v. Sourthern Pac. Co.*, 279 F. 832, 840 (2d Cir.), *cert. denied*, 258 U.S. 628, 42 S.Ct.

[7] Because it is the equivalent of an *extraordinary* cash dividend, the distribution of the MAC stock is not governed by the provisions of Article 5, Section 2 of the Indenture, which apply only to "regular dividends" and exclude "extraordinary dividends of every character." Appendix at 348a-49a.

461, 66 L.Ed. 799 (1922). Had the B & O indenture contained a more broadly inclusive notice clause, B & O might have been required to inform the debenture holders prior to the declaration of the MAC dividend. The sample provision quoted above, for example, requires notice both for dividends "payable in stock of any class" and for "any other distribution," excluding normal cash dividends. Kaplan, *supra* note 4, at 13 n.24. But the fact remains that the B & O indenture contains no such clause. Accordingly, the plaintiffs cannot rely upon the terms of the indenture as a source of B & O's purported duty to speak.

Apparently mindful of the limited protection afforded to them by the indenture, the plaintiffs maintain that, notwithstanding any lack of an adequate notice provision within the indenture, New York's law of fair dealing required that in any event notice be given prior to the declaration of the MAC dividend. Judge Gibbons credits this argument, concluding that, in failing to give notice, B & O violated the principle "that in every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract. . . ." At 941 (quoting *Kirke La Shelle Co. v. Paul Armstrong Co.*, 263 N.Y. 79, 87, 188 N.E. 163, 167 (1933)).

Such an analysis is clearly inappropriate. By its terms, the principle of fair dealing expressed in *Kirke* and quoted by Judge Gibbons applies only when one party in- [952] fringes the other's *rights* "to receive the fruits of the contract." Here, under the well-settled *Parkinson* doctrine, Pittsburgh Terminal *had no right*, under the

contract, to receive advance notice of the MAC dividend because *no anti-dilution provision to that effect had been included in the indenture.* Thus, the risk of dilution was "inherent in the investment made by the holders of Debentures.... [B & O] did nothing that could be described as 'destroying or injuring the right of the other party to receive the fruits of the contract,' because ... the benefits that the holders of Debentures received were all the rights to which they were contractually entitled." *Broad v. Rockwell International Corp., supra,* at 958.

Van Gemert v. Boeing Co., 520 F.2d 1373 (2d Cir.), *cert. denied,* 423 U.S. 947, 96 S.Ct. 364, 46 L.Ed.2d 282 (1975), *appeal after remand,* 553, F.2d 812 (2d Cir. 1977), a Second Circuit case relied upon by Judge Gibbons, does not support a contrary result. In *Van Gemert,* debenture holders complained that Boeing had provided inadequate notice of its intention to redeem the debentures, thereby depriving the investors of the opportunity to convert prior to redemption. The Second Circuit agreed. Observing that the newpaper notice that was provided "may have conformed to the requirements of the Indenture," the court nonetheless concluded that such notice "was simply insufficient" under New York's fair dealing law "to give fair and reasonable notice to the debenture holders." 520 F.2d at 1383. In its decision after remand, the court clarified its earlier decision:

> We did find significant ... the fact that the debentures did not explicitly set forth the type of notice which appellants could expect if Boeing decided to call the bonds. Without such a declaration, we held as a matter of law that appellants were entitled to expect that Boeing would

> employ a method of notification reasonably calculated to inform the debenture holders of the call.

553 F.2d at 815.

Van Gemert thus stands for the narrow proposition that, if the debenture holders are contractually entitled to notice, such notice must be "fair and reasonable." But *Van Gemert* in no way addresses the question posed to us today: namely, whether the B & O debenture holders were entitled to any notice at all. That question, as has already been suggested, can be answered only by reference to the language of the indenture itself.

II.

The conclusion that B & O was under no contractual obligation to provide advance notice of the MAC dividend to its convertible debenture holders does not, of course, end the inquiry. For while it is clear that as a general rule, the debenture holders' rights are limited to those specified in the indenture, the Court today has determined that SEC Rule 10b-17 furnishes an independent statutory source from which to derive a duty, on the part of B & O, to provide notice of the MAC dividend. I turn, therefore, to an examination of this issue.

Rule 10b-17 provides that

> (a) It shall constitute a "manipulative or deceptive device or contrivance" as used in section 10(b) of the Act for any issuer of a class of securities . . . to fail to give notice in accordance with paragraph (b) of

this section of the following actions *relating to such class of securities:*

(1) A dividend or other distribution in cash or in kind, except an ordinary interest payment on a debt security, but including a dividend or distribution of any security of the same or another issuer; . . . .

17 C.F.R. §240.10b-17 (1981) (emphasis added). Judge Gibbons has concluded that Rule 10b-17 applies to the situation at hand because "B & O is the issuer of the convertible debentures, the MAC distribution is a dividend of a security, and that dividend related to the convertible debentures since it was material to a decision about exercising the conversion option." At 941. Judge Garth, concurring exclusively on this ground, stresses that, in his view, "a divi- [953] dend 'relates to' a security if the declaration of that dividend makes the security significantly more or less valuable. . . ." At 945. Because the B & O debentures were of considerably less value after the declaration of the MAC dividend, Judge Garth has concluded that the declaration of the dividend "is an action which clearly 'relates to' " that class of securities.

I do not disagree that the MAC dividend may have been "material" to the debenture holders' decision whether or not to convert their securities into shares of common stock. Nor do I take issue with Judge Garth's determination that the debentures were less valuable after the declaration of the dividend. Nonetheless, in my view, these considerations are not sufficient to establish that the dividend declaration "related to" the class of debenture securities as that term is used in Rule 10b-17. Put simply, Rule 10b-17 never was meant to deal with a situation similar to that before us today.

Appendix C—Opinion of the United States Court of Appeals for the Third Circuit (1982).

Nothing in the Commission's "Notice of Proposed Rule Making" or in the language of the rule itself suggests that Rule 10b-17 was intended to override the common law and accord debenture holders significant additional *substantive* rights. When the Rule was proposed by the Securities Exchange Commission in 1971, it was described as a rule "to require companies whose securities are publicly traded to furnish public investors with timely advance notice of the *right to receive dividend*[s] *and other rights which accrue to holders of record* of a specified class of securities as of a specialized date ('the record date')." 36 Fed.Reg. 3430 (1971). In other words, the Rule was designed to ensure that purchasers of securities receive all the fruits of the transaction *to which they legally are entitled*—namely, distributions made after the sale but before the change in ownership is reflected in the corporation's record books.[8] Detailing the circumstances that had prompted the proposal, the Commission explained:

[8] The Rule presumably provides a remedy for sellers as well. *See Lutgert v. Vanderbilt Bank*, 508 F.2d 1035 (5th Cir. 1975). In *Lutgert*—the only case to my knowledge that has discussed the intended scope of Rule 10b-17—the court described "the type of claim for which Rule 10b-17 was intended to provide relief":

> For example, if the owner of . . . stock prior to the record date were to sell his stock within the ten-day disclosure period referred to in Rule 10b-17 unaware, due to defendants' nondisclosure, that the record date had been set, it is conceivable that he might make out a claim for relief under Rule 10b-17. Plaintiff in such a case would have been a seller of . . . stock and would have been defrauded in connection with that sale.

508 F.2d at 1038-39.

> When an issuer establishes a record date it is, in general, obligated to furnish the cash, securities, or other property or property rights that are the subject of the distribution only to those persons owning the underlying security as reflected in the issuer's records. However, not all transactions occurring prior to that cut-off date can be settled and appropriate changes effected on the issuer's records to provide assurance that the distributions of the rights will actually be made by the issuer to purchasers. Since during this period purchasers pay a price for the underlying security which indicates the value of the asset to be distributed, it has therefore been the practice and custom of the trade for brokers and dealers to render the purchaser as the person entitled to the distribution which is made by the issuer to the seller as record owner. *If the participating brokers have notice of the cut-off date, they can take necessary steps at settlement . . . to protect the right of the purchaser to the distribution and at the same time alert the seller to his obligation to turn over the distributed property to the purchaser.*

Id. at 3430-31 (emphasis added). The failure of publicly held corporations to provided such notice.

> has had a misleading and deceptive effect on both the broker-dealer community and the investing public. As a direct result of such failure, purchasers and their brokers may have entered into and settled securi- [954] ties transactions without knowledge of the accrual of such rights and were thus unable to take necessary steps to protect their interests.

> Further, sellers who have received the benefits of such rights as recordholders on the specified record date after having disposed of their securities, have also disposed of the cash or stock dividends or other rights received as such recordholders without knowledge of possible claims of purchasers of the underlying security to those rights.

Id. at 3430.

The differences between the scenario depicted by the SEC and the present case could not be more obvious. In the situation described by the SEC, the purchaser—independent of Rule 10b-17—has accrued the *right* to receive certain benefits. In such a case, the Rule acts simply to assure that these rights will not be impeded because of the inadequacies inherent in corporate bookkeeping. Here, in contrast, the debenture holders have a right to convert their debentures into shares of common stock. That right has not been defeated. Under well-established common law principles, however, they have no right—unless otherwise specified in the debenture—to notice of corporate actions that may affect the value of the conversion option.

III.

Had the debenture holders foreseen the possibility that B & O would spin off its non-rail assets, arguably they may have bargained for—and paid for—the right to

advance notice of the event.[9] Despite the well-settled precedent of *Pratt* and *Parkinson*, however, the B & O indenture did not require such notice to the debenture holders and the price of the debenture presumably reflected this fact. For this Court today—almost thirty years after the drafting of the indenture—to ignore what was set forth as the intent of the parties and fundamentally to alter the terms of the contract is, in my view, not only legally erroneous but improvident.[10]

I therefore respectfully dissent.[11]

---

[9] Concededly, the debenture holders themselves do not, in the average case, bargain individually with the issuing corporation. *See* Note, *Convertible Securities: Holder Who Fails to Convert Before Expiration of the Conversion Period*, 54 Cornell L.Rev. 271, 272 (1969). But attorneys or investment bankers normally perform this function on behalf of the debenture holders as a class, *see, e.g.*, Hills, *supra* note 4; Kaplan, *supra* note 4, and there is no suggestion in this case that those persons who bargained on behalf of the B & O debenture holders did so other than with diligence and vigor.

[10] In this regard it is instructive to consider the view expressed by Judge Tyler in *Entel v. Guilden*, 223 F.Supp. 129, 131-32 (S.D.N.Y. 1963):

> One of the chief economic functions of a corporation, obviously, is to facilitate aggregations of capital. To further this function, there has developed a broad range of modes of investment within the corporate framework. Each such mode is a bundle of legal rights and duties: the market price for each bundle is no doubt determined at least in part by what the bundle contains. Thus, courts should act with conservatism in changing the content of any of these bundles in ways which would give the holders of some bundles less, and holders of other bundles more, than was bargained for in the marketplace.

[11] Judge Gibbons has posed two additional sources from which he derives a duty to speak—namely, the New York Stock Exchange Listing Agreement and the Maryland law of fiduciary obligations. While the court's holding does not rest on either of these alleged sources, I note that, for essentially the reasons stated in parts I and II of this opinion, I find that neither the listing agreement nor the Maryland law creates the asserted duty to provide notice in this context.

APPENDIX D

Excerpt of Appellate Argument Transcript, January 17, 1985

UNITED STATES COURT OF APPEALS
For the Third Circuit

PITTSBURGH TERMINAL CORPORATION, *et al.*,
Appellants,

vs.

THE BALTIMORE & OHIO RAILROAD CO., *et al.*

No. 84-3331.

MONROE GUTTMANN, *et al.*,
Appellants,

vs.

THE BALTIMORE & OHIO RAILROAD CO., *et al.*

No. 84-3332.

United States Courthouse
601 Market Street
Philadelphia, Pennsylvania

January 17, 1985

Appendix D—Excerpt of Appellate Argument Transcript, January 17, 1985.

CORAM:

THE HONORABLE JAMES HUNTER, III, J.
Circuit Judge

THE HONORABLE A. LEON HIGGINBOTHAM, JR., J.
Circuit Judge

THE HONORABLE JAMES KELLY, J.
District Judge

Appendix D—Excerpt of Appellate Argument Transcript, January 17, 1985.

* * *

[19] It seems to me that they shouldn't get it, certainly with respect to the B & O, which they always could have owned and certainly with respect to MAC which they could have had MAC in February. But I feel that that can be adjusted.

I would also point out, if I may at this point, Your Honors, with respect to Judge Webber's award, it is slightly amended to this extent as we disclosed in our brief, we are presently willing that the stock be registered and have taken steps, and are prepared to complete those steps so that they will receive the registered stock. So I don't feel that that issue should hold this Court up. And in registering the stock, if I may add this, it will also be present in the award that they receive, there will be a registration statement filed with the SEC. That registration statement will be provided to them prior to their having to make their decision as to whether—

THE COURT: What is it that's registered today because of this litigation for it?

MR. WENTLEY: Frankly, Your Honor, if we're giving this to all the other debentureholders, now if there are so many, it would seem to me registration is important but the real issue, to be very blunt with you,

* * *

APPENDIX E

Offer of Judgment Filed August 3, 1984

IN THE
UNITED STATES DISTRICT COURT
For the Western District of Pennsylvania

MONROE GUTTMAN, LORETTA GUTTMANN, JANET REES and EVELYN BITTNER,
Plaintiffs,

v.

THE BALTIMORE AND OHIO RAILROAD COMPANY, W. JAMES PRICE, ALONZO G. DECKER, JR., JAMES PARKER NOLAN, FREDERICK DEANE, JR., JAMES L. O'KEEFE, GREGORY S. DeVINE, FAY A. LeFEVRE, NICHOLAS T. CAMICIA, DR. MILTON S. EISENHOWER, STEVEN MULLER, JOHN K. STEVENSON, HAYS T. WATKINS, HOWARD E. SIMPSON and CYRUS S. EATON, all Directors or former Directors of the Baltimore and Ohio Railroad, The Chesapeake and Ohio Railroad and/or the Chessie System; THE CHESAPEAKE AND OHIO RAILROAD and THE CHESSIE SYSTEM, INC.,
Defendants.

Civil Action No. 79-94

PITTSBURGH TERMINAL CORPORATION,
Plaintiff,

v.

THE BALTIMORE AND OHIO RAILROAD COMPANY, THE CHESAPEAKE AND OHIO RAILROAD and THE CHESSIE SYSTEM, INC.,
Defendants.

Civil Action No. 77-1455

Appendix E—Offer of Judgment Filed August 3, 1984.

OFFER OF JUDGMENT

TO: Michael P. Malakoff, Esq.
508 Law and Finance Building
Pittsburgh, PA 15219

Attorneys for Plaintiffs

The Defendants, The Baltimore and Ohio Railroad Company, The Chesapeake and Ohio Railroad and the Chessie System, Inc., pursuant to Rule 68 of the Federal Rules of Civil Procedure, offer to allow judgment to be taken against them by the plaintiffs in the above-captioned matters, by affording plaintiffs the opportunity to convert their B&O Convertible 4½% Debentures into shares of B&O common stock and receive as a dividend, as of December 13, 1977, the shares of Mid-Allegheny Corporation stock declared payable as a dividend to shareholders of record of B&O common stock on December 13, 1977. Defendants, above-named, also will provide the plaintiffs with sufficient information to enable them to make an informed investment decision concerning the opportunity to convert their Debentures and receive the Mid-Allegheny Corporation dividend. In accordance with Rule 68, this Offer of Judgment also includes the costs now accrued.

Richard T. Wentley
Peter Denby
Anthony J. Basinski

Reed Smith Shaw & McClay
747 Union Trust Building
Pittsburgh, Pennsylvania 15219

Date: February 12, 1979

Appendix E—Offer of Judgment Filed August 3, 1984.

CERTIFICATE OF SERVICE

I hereby certify that on this 3rd day of August, 1984, I served a true and correct copy of the foregoing by first-class mail, postage prepaid, on:

Michael P. Malakoff, Esquire
508 Law and Finance Building
Pittsburgh, PA 15219

G. F. Sharlock, Esquire
1110 Two Chatham Center
Pittsburgh, PA 15219

ANTHONY J. BASINSKI
Anthony J. Basinski

APPENDIX F

Stipulation Filed May 2, 1980

IN THE
UNITED STATES DISTRICT COURT
For the Western District of Pennsylvania

MONROE GUTTMANN, LORETTA GUTTMANN, JANET REES and EVELYN BITTNER,
Plaintiffs,

v.

THE BALTIMORE AND OHIO RAILROAD COMPANY, *et al.*,
Defendants.

Civil Action No. 79-94

PITTSBURGH TERMINAL CORPORATION,
Plaintiff,

v.

THE BALTIMORE AND OHIO RAILROAD COMPANY, *et al.*,
Defendants.

Civil Action No. 77-1455

AFFIDAVIT

STATE OF OHIO }
COUNTY OF CUYAHOGA } ss:

ROBERT F. HOCHWARTH, being duly sworn according to law, does hereby depose and say as follows:

1. I am employed as a General Attorney for Chessie System, Inc. ("Chessie"). In that position I also have

responsibilities for legal matters involving The Baltimore and Ohio Railroad Company ("B & O") and The Chesapeake and Ohio Railway Company ("C & O").

2. In my position as General Attorney, I have become closely familiar with the three lawsuits pending in the district against the B & O, C & O and Chessie brought by certain convertible debentureholders of the B & O: *Guttmann v. B&O*, C. A. No. 79-94, *Pittsburgh Terminal Corp. v. B&O*, C. A. No. 77-1455 and *Lowry v. B&O*, C. A. No. 79-1504B.

3. With respect to these lawsuits, my duties have included informing the Trustee under the Indenture pursuant to which the Debentures were issued, The Chase Manhattan Bank ("Chase"), of their status and progress.

4. In addition, on behalf of the B & O, C & O and Chessie, I have advised Chase that should the plaintiffs in the *Pittsburgh Terminal* and *Guttmann* actions prevail on the merits of their claims at trial or should a settlement of these claims be reached before trial, all holders of debentures as of December 13, 1977, whether or not they were subsequently converted, will be permitted to participate in the Court judgment or settlement on the same terms as the plaintiffs.

5. The most recent communication from the Chase confirming this agreement is a letter dated August 21, 1979 from James D. Heaney, Corporate Trust Officer for the Chase, to myself, a true and correct copy of which is attached hereto as Exhibit "A" and made a part hereof.

Appendix F—Stipulation Filed May 2, 1980.

This letter accurately reflects the nature of the commitment by the B & O, C & O and Chessie.

_____

Robert F. Hochwarth

Sworn to and subscribed before me this _____ day of April, 1980.

_____

Notary Public

My commission expires:

Appendix F—Stipulation Filed May 2, 1980.

EXHIBIT A

The Chase Manhattan Bank, N.A.
1 New York Plaza
New York, New York 18015

CHESSIE SYSTEM
AUG 27 1979
RECEIVED
Law Department

Logo
CHASE

August 21, 1979

Mr. Robert Hochwarth
General Attorney
Chessie System
Terminal Tower
P. O. Box 6419
Cleveland, Ohio 44101

Dear Mr. Hochwarth:

Baltimore & Ohio Railroad Company
Convertible 4½% Debentures Series A
Due January 1, 2010

This will confirm our telephone conversation of July 30, 1979 with respect to the recent B & O stock Dividend, and the cash dividend to be payable September 4, 1979 to holders of record August 1, 1979. It is our understanding that holders of the above Convertible Debentures who do, or do not convert, such Debentures, in order to collect the above-mentioned cash dividend will

be protected by B & O and allowed to participate on a like basis in the settlement, if any, with, or the court judgement, if any, in favor of the plaintiff in the action Pittsburgh Terminal Corporation vs. The Baltimore & Ohio Railroad Company, et al, and/or Monroe Guttmann, Loretta Guttmann, Janet Rees and Evelyn Bittner vs. The Baltimore & Ohio Railroad et. al.

Yours very truly,

JAMES D. HEANEY
James D. Heaney
Corporate Trust Officer

amj

APPENDIX G

Excerpt of Affidavit of Monroe Guttmann
Filed October 20, 1983

IN THE
UNITED STATES DISTRICT COURT
For the Western District of Pennsylvania

PITTSBURGH TERMINAL CORPORATION,
Plaintiff,

vs.

THE BALTIMORE AND OHIO RAILROAD COMPANY, *et al.,*
Defendants.

Civil Action No. 77-1455

MONROE GUTTMANN, LORETTA GUTTMANN, JANET REES and EVELYN BITTNER,
Plaintiffs,

vs.

THE BALTIMORE AND OHIO RAILROAD COMPANY, *et al.,*
Defendants.

Civil Action No. 79-94

AFFIDAVIT OF MONROE GUTTMANN

COMMONWEALTH OF PENNSYLVANIA }
COUNTY OF ALLEGHENY } ss:

Monroe Guttmann, being duly sworn, deposes and says that:

Appendix G—Excerpt of Affidavit of Monroe Guttmann Filed October 20, 1983.

I. STATUS OF AFFIANT

1. I am the President and principal shareholder of Pittsburgh Terminal Corporation ["PTC"], Plaintiff in Civil Action No. 77-1455 (W.D.Pa.) and one of the Plaintiffs in Civil Action No. 79-94 (W.D.Pa.) along with Loretta Guttmann, Janet Rees and Evelyn Bittner.

2. Loretta Guttmann, Janet Rees and I have sold some of our debentures which we acquired prior to December 13, 1977 in reliance on the Defendants' affidavit (App. 188a) that those who held debentures on December 13, 1977 would be entitled to receive the remedy awarded by the Court or received in settlement in the Civil Action Nos. 79-94 and 77-1455 (W.D.Pa.).

3. As the owner and registered holder of 400 shares of the common stock of Baltimore & Ohio Railroad Co. ["B&O"] since prior to December 13, 1977, PTC received 400 shares of Mid Allegheny Corporation ["MAC"] common stock declared as a dividend on its B&O shares on December 13, 1977. There were only 12 other public shareholders who received MAC stock as a

* * *

APPENDIX H

Opinion of the United States District Court for the Southern District of California
In Re: Nucorp Energy Securities Litigation

UNITED STATES DISTRICT COURT
Southern District of California

In Re: NUCORP ENERGY SECURITIES
Litigation

M.D.L. 514

This document relates to:
82-1796-JLI(M) (PHELPS)

MEMORANDUM DECISION AND ORDER

In October 1982, the plaintiffs in the above action ("subsequent purchasers"), alleging to be present holders of Nucorp 19¾% debentures, filed a complaint in the Northern District of Illinois against Continental Illinois National Bank & Trust Company of Chicago ("Continental"), predicating federal jurisdiction on alleged violations of the Trust Indenture Act of 1939, 15 U.S.C. §§77aaa *et seq.* The action was subsequently transferred to this Court by the Judicial Panel on Multidistrict Litigation pursuant to 28 U.S.C. §1407.

Continental moved to dismiss the complaint, arguing it fails to state a claim. The plaintiffs in the main action interposed a rule 12(h)(3) jurisdictional suggestion, requesting the Court dismiss the complaint for lack of subject matter jurisdiction.

Appendix H—Opinion of the United States District Court for the Southern District of California In Re: Nucorp Energy Securities Litigation.

The Court, having considered the memoranda filed by all counsel, the oral argument at the hearing, and the supplemental memoranda regarding the propriety of retaining the pendent state claims, hereby dismisses Count One of the complaint.

BACKGROUND

This Court has, on prior occasion, had the opportunity to pass on the propriety of a claim brought by plaintiffs purchasing debentures after curative information has been released to the public.

Similar subsequent purchaser plaintiffs, represented by the same counsel, sued the officers and directors of Nucorp, together with other entities, for violations of the Securities Act of 1933, The Securities Exchange Act of 1934, and several state pendent claims. *Handleman v. Bell*, 82-1378-JLI(M). The plaintiffs in the *Handleman* action had purchased Nucorp's 19¾% convertible debentures after the close of the class period (January 20, 1982). It was their theory of recovery that they owned federal securities claims by an assignment of operation by law pursuant to §13-107 of the New York General Obligations Law (McKinney's 1978).

In *Handleman*, this Court rejected that theory, and dismissed the complaint in its entirety by an order entered February 14, 1983. Dismissal was without prejudice, however, in the event the subsequent purchaser plaintiff could allege an express assignment of the federal securities claims. It is the court's understanding that the pendent state claims are presently being litigated in the New York State Courts.

Appendix H—Opinion of the United States District Court for the Southern District of California In Re: Nucorp Energy Securities Litigation.

DISCUSSION

Trust Indenture Act Claim

The first issue to be resolved is whether the Trust Indenture Act Claim is properly before this court.

As noted above, this Court rejected the arguments put forward by subsequent purchaser plaintiffs in *Handleman*, relying substantially on the following language from *Independent Investors Protection League v. Saunders*, 64 F.R.D. 564 (E.D. Pa. 1974):

> While a security is of course transferred by its sale, the causes of action belonging to a prior holder do not pass with the transfer of the security. The provisions of the securities acts relied upon here create rights of action on the part of investors who have been harmed by the misconduct of others. Those rights belong to the *persons* who have suffered injury. They do not attach for all eternity to the security itself, to pass forever from the person who has been harmed to be asserted by others who have not. To adopt plaintiffs' extraordinary theory would be to deprive injured persons of their rights and give their cause of action to one who has suffered no injury himself but who simply has been shrewd or lucky enough to have put his hands on a security that once belonged to a person who was defrauded.

64 F.R.D. at 572.

The subsequent purchaser plaintiffs in this action have sued Continental Illinois under the Trust Indenture Act

of 1939, 15 U.S.C. §§77aaa. Two reasons compel this Court to reach a similar conclusion as to the plaintiffs' claim in this action, as under the Securities Act of 1933 and Securities Exchange of 1934 claims.

First, the Trust Indenture Act of 1939 is part of the same framework of securities laws as the 1933 and 1934 acts, which have the purpose of protecting investors. *Wilko v. Swan*, 346 U.S. 427, 430-31 (1953). Certainly, allowing the mere transfer of a security without express assignment, whether it be a stock certificate or a bond within the scope of the Trust Indenture Act, to transfer rights belonging to one defrauded, would not enhance this purpose: the one defrauded would be without remedy.

Second, the express right of action found in the 1939 act, 15 U.S.C. §77www, Liability for Misleading Statements, requires the element of reliance for a finding of liability. It is beyond doubt that plaintiffs could not have relied on misleading statements at such a late date, nor do they allege reliance in this complaint.

These factors, therefore, compel this Court to dismiss Count One of the complaint.

Pendent Claims

At oral argument, for the first time, counsel for Continental requested that the pendent claims, Counts Two through Five not be dismissed. Because the Court had not had the opportunity to address the status of the pendent claims, further briefing was ordered.

Appendix H—Opinion of the United States District Court for the Southern District of California In Re: Nucorp Energy Securities Litigation.

It is the position of both Continental and the class plaintiffs that this Court has the discretion to retain jurisdiction over these claims. They argue that, while the Trust Indenture Act claim should properly be dismissed, such a dismissal is on the merits, rather than for lack of jurisdiction.

The Court is in substantial agreement with the analysis of Continental with regard to whether pendent jurisdiction exists over these claims. The issue presented as to the subsequent purchaser plaintiffs' cause of action under the Trust Indenture Act is one of standing. This Court, as detailed above, finds no standing by one purchasing bonds after curative information has been released to proceed on federal securities claims, absent some express assignment. The dismissal then, rather than being jurisdictional, is on the merits, and for all practical purposes with prejudice because it appears no express assignments of federal securities claims were executed.

The subsequent purchaser plaintiffs' based jurisdiction upon the Trust Indenture Act and this Court certainly had the authority to determine that claim.

In *Hagans v. Lavine,* 415 U.S. 528, 536-37 (1974), the Court reviewed the standard for dismissal for lack of jurisdiction:

Appendix H—Opinion of the United States District Court for the Southern District of California In Re: Nucorp Energy Securities Litigation.

> Over the years, the Court has repeatedly held that the federal courts are without power to entertain claims otherwise within their jurisdiction if they are "so attenuated and insubstantial as to be absolutely devoid of merit" (citation) "obviously frivolous" (citation) "plainly unsubstantial" (citation) or "no longer open to discussion."

In this case, it cannot be said that the claim of these subsequent purchasing plaintiffs was obviously without merit or wholly frivolous. While the cases for the most part give little support to these plaintiffs' position, three dissenting judges from the Third Circuit would apparently find that Federal Securities claims pass automatically to the purchasers of the security. *Lowry v. Baltimore & Ohio R.R. Co.*, 707 F.2d 721 (3d Cir. 1983) (*en banc*) (Gibbons, Jr., dissenting; Seitz, C.J. and Becker, J., concurring & dissenting). Given this support, though in the minority, it is obvious the claims raised here have some merit. It is the court's finding, then, that the dismissal was on the merits in the case.

The result of such a finding is that the Court has pendent jurisdiction over the state claims. The issue then becomes whether the court should exercise its discretion and hear these claims.

While a difficult question, the court believes that judicial economy and the potential problem of double liability dictate retention of these state claims.

Appendix H—Opinion of the United States District Court for the Southern District of California In Re: Nucorp Energy Securities Litigation.

Accordingly, IT IS HEREBY ORDERED that Count One of the Complaint, in this action, is dismissed. The Court will retain jurisdiction over Counts Two through Five, and will hear argument on the substantive motions to dismiss those Counts at the November 10, 1983, status conference.

DATED: October 24, 1983.

J. LAWRENCE IRVING
J. Lawrence Irving, *Judge*
UNITED STATES DISTRICT COURT

COPIES TO ALL COUNSEL

APPENDIX I

Excerpt of B&O's Supplemental Brief in the Court of Appeals *Lowry v. Baltimore & Ohio R.R. Co.*

UNITED STATES COURT OF APPEALS
for the Third Circuit

81-1976

LUCILE LOWRY AND LOWRY-ZWEIG CORP.,
Plaintiffs-Appellants,

v.

THE BALTIMORE AND OHIO RAILROAD COMPANY, THE CHESAPEAKE AND OHIO RAILWAY COMPANY AND CHESSIE SYSTEM, INC.,

Defendants-Appellees.

Appeal From The United States District Court
For The Western District of Pennsylvania
(No. 79-1504-B)

APPELLEES' SUPPLEMENTAL BRIEF

Richard T. Wentley, Esq.
Anthony J. Basinski, Esq.
Terrance K. Livingston, Esq.
Reed Smith Shaw & McClay
747 Union Trust Building
Pittsburgh, Pennsylvania 15219
(412) 288-3098

Attorneys for Appellees,
The Baltimore and Ohio Railroad Company, The Chesapeake and Ohio Railway Company and Chessie System, Inc.

* * *

Appendix I—Excerpt of B&O's Supplemental Brief in the Court of Appeals Lowry v. Baltimore & Ohio R.R. Co.

In accordance with the above discussion, it is apparent that neither federal nor state law provides for the assignability of the type of claims asserted by plaintiffs. In both instances those laws preclude recovery by the plaintiffs in this action since each representative plaintiff and the class which they seek to represent purchased their debentures *after* they learned of the alleged fraud and after the dividend had been declared. The stipulation in *Pittsburgh Terminal Corp. v. Baltimore and Ohio Railroad Co., et al.* at Nos 81-1674/1675 relates to the debenture holders who owned their debentures on the day of the declaration of the MAC dividend whether or not they subsequently sold or converted their debentures. It was intended to insure that all of those debenture holders would be treated in exactly the same manner as the plaintiffs in those two consolidated actions should they prevail on the merits of their claims. This agreement was made with the trustee under the Indenture, the Chase Manhattan Bank, and was intended to provide full protection for all of the debenture holders, whether or not they were formal parties to those suits.

It should be noted that the trustee under the Indenture has never indicated its intention to pursue any claims against the defendants although under the terms of the Indenture it is obligated to do so if it perceives any fraud or other irregularity in any action by the issuer.

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